Supreme Court, U.S.
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No. ___

IN THE

Supreme Court of the United States

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
and
LUCENT TECHNOLOGIES INC.,
Petitioners,

v.

THE UNITED STATES,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether an aggrieved government contractor can pursue contractual remedies against the United States for violating a statutory prohibition mandating adherence to a congressional procurement policy intended to protect government contractors against significant financial risk when performing research and development essential to the national defense.

RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Petitioner American Telephone and Telegraph Company has no parent corporation, and there is no publicly held company that owns 10 percent or more of its stock.

Petitioner Lucent Technologies Inc. has no parent corporation, and there is no publicly held company that owns 10 percent or more of its stock.

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PETITION FOR A WRIT OF CERTIORARI

This is a case about the fundamental right of government contractors to obtain judicial relief when an Executive Branch department or agency violates congressional procurement policies enacted into law as mandatory statutory requirements or prohibitions. The legal issues in this case, which implicate the integrity of the constitutionally based federal procurement system, have confounded the U.S. Court of Appeals for the Federal Circuit and the U.S. Court of Federal Claims for almost a decade. Now that the Federal Circuit has issued its third (and final) opinion, this case needs, and is ready for, Supreme Court review. Accordingly, Petitioners American Telephone and Telegraph Company ("AT&T") and Lucent Technologies Inc. respectfully request the Court to grant their petition for a writ of certiorari.

OPINIONS BELOW

The Federal Circuit's opinion (App. at 1a) is reported at 307 F.3d 1374. The Court of Federal Claims opinion, which the Federal Circuit affirmed, is reported at 48 Fed. Cl. 156 (App. at 21a). Other opinions and orders issued in this case are reported at 177 F.3d 1368 (en banc opinion) (App. at 33a); 136 F.3d 793 (accepting suggestion to rehear appeal en banc and vacating panel opinion) (App. at 73a); 124 F.3d 1471 (panel opinion) (App. at 75a); 33 Fed. Cl. 540 (certifying issues for interlocutory appeal) (App. at 104a); and 32 Fed. Cl. 672 (App. at 108a).

JURISDICTION

The final judgment of the court of appeals was entered on October 8, 2002. A timely petition for rehearing

en banc was denied on January 27, 2003 (App. at 19a). This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

Section 8118 of the Defense Appropriations Act of 1988, provided as follows:

> None of the funds provided for the Department of Defense in this Act may be obligated or expended for fixed price-type contracts in excess of $10,000,000 for the development of a major system or subsystem unless the Under Secretary of Defense for Acquisition determines, in writing, that program risk has been reduced to the extent that realistic pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties: Provided, That the Under Secretary may not delegate this authority to any persons who hold a position in the Office of the Secretary of Defense below the level of Assistant Secretary of Defense: Provided further, That the Under Secretary report to the Committees on Appropriations of the Senate and House of Representatives in writing, on a quarterly basis, the contracts which have obligated funds under such a fixed price-type developmental contract.

Act of Dec. 22, 1987, Pub. L. No. 100-202, § 8118, 101 Stat. 1329, 1329-84.

STATEMENT OF THE CASE

This case raises the question of whether the Department of Defense ("DoD") – or any federal department or agency – can violate a procurement statute that was

intended to protect the interests of government contractors, profit from that violation to the great financial detriment of government contractors, and then avoid all judicial redress when an aggrieved government contractor files suit in the U.S. Court of Federal Claims. The U.S. Court of Appeals for the Federal Circuit and the Court of Federal Claims have struggled with this issue and case for almost ten years. As the tangle of inconsistent opinions previously issued in this case reflect (*see* Appendix, *infra*), both courts have been perplexed, and the court of appeals has been divided, over the legal issues presented by DoD's indisputable violation of a mandatory statutory prohibition against use of fixed-price research and development contracts for major military defense systems. The opinion below is the third (and final) of three, contradictory, Federal Circuit opinions (including an earlier, *en banc* opinion), each of which was issued over a sharply worded dissent.

In the opinion below, a majority panel of the court of appeals held that despite DoD's clear-cut violation, no judicial relief is available where, as is virtually always the case, the procurement statute imposing the requirement or prohibition that has been violated does not also include an explicit right of action. Thus, according to the opinion below, a contractor aggrieved by such a violation cannot pursue traditional contractual remedies, such as compensation based on reformation of an illegal contract term, or *quantum meruit* recovery based on an implied-in-fact contract. As a result of DoD's violation (which was one of many DoD violations of the same or similar statutes), Petitioner AT&T lost more than $55 million in performing research and development that was essential to the national defense. Now AT&T and its successor-in-interest, co-Petitioner Lucent Technologies Inc., after a decade of litigation, have been denied the right to seek any judicial relief.

1. The United States Government heavily depends upon contractors to provide an almost endless list of goods and services. This includes extremely complex research and development needed for military defense systems, and also for other essential purposes such as homeland security. DoD normally procures new military defense systems through award of research and development contracts, which due to the nature of the work, involve long-term contractual commitments, technological obstacles, and extraordinary financial risks. Thus far in FY 2003, Congress has appropriated more than $130 billion for defense-related procurement, including for state-of-the-art research and development. *See* Kerry Gildea, *Bush Signs $355 Billion Defense Appropriations Bill*, Defense Daily, Oct. 24, 2002.

At the nation's founding it was assumed that pursuant to the War Powers vested in Congress by Article I of the Constitution, most military weapons would be designed and manufactured by the Government in its own "Arsenals" and "dock-Yards." U.S. Const. art. I, § 8, cl. 17. But what has evolved, particularly during the last century, is a base of private contractors essential to the development and production of military defense systems which are vastly more complex than the Founders could have envisioned. There is a necessary partnership between the Government and this "defense industrial base." As discussed below, the federal procurement statute at issue here expressly recognized the need to preserve that relationship.

Despite their critically important role, government contractors have very little bargaining power regarding the terms and conditions of the contracts upon which they bid. *See* John Cibinic, Jr., *Retroactive Legislation and Regulations and Federal Government Contracts*, 51 Ala. L. Rev. 963, 975 (2000) ("Most government contracts, regardless of type, are contracts of adhesion which leave little or no room for negotiation of terms."). Instead, the

Federal Acquisition Regulation ("FAR"), 48 C.F.R. Part 52, and FAR supplements issued by individual departments and agencies, set forth a myriad of required contract clauses. Nevertheless, Congress sometimes acts to protect the interests of contractors – especially contractors which comprise the nationally vital, defense industrial base – by including in particular authorization, appropriation, or other procurement-related statutes, specific requirements or prohibitions relating to certain material contract terms. Such terms include, for example, the basis on which a contractor will be paid for its work (e.g., fixed-price basis; cost-reimbursement basis). The Executive Branch, including DoD, must adhere to Congress' statutory requirements and prohibitions when awarding contracts.

2. The statute at issue in this appeal, § 8118 of the Defense Appropriations Act of 1988, addressed Congress' longstanding concern about DoD's persistent use of fixed-price contracts (rather than cost-reimbursement contracts) for technologically challenging, financially risky, research and development projects involving major military defense systems. As the court of appeals explained in its earlier, *en banc* opinion in this case, a House Appropriations Committee investigation had "concluded that for the development phases of new technologies, the Navy's use of fixed price contracting resulted in program delays, cost overruns, contractor claims, non-participation, and litigation." App. at 37a. In view of "congressional concern that the risks of failure and of cost uncertainties be allocated equitably between government and contractor [and] the desire to '*maintain the government's credibility as a reliable business partner*' . . . Congress acted to adjust the risks of developing the advanced technologies needed in the service of national defense" by enacting § 8118. *Id.* at 39a (quoting H.R. Conf. Rep. No. 100-498, at 623 (Dec. 22, 1987)) (emphasis added).

Section 8118 prohibited the use of appropriated funds to award "fixed price-type contracts in excess of $10,000,000 for the development of a major system or subsystem unless the Under Secretary of Defense for Acquisition determines, in writing, that program risk has been reduced to the extent that realistic pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties." Pub. L. No. 100-202, § 8118. The statute further provided that "the Under Secretary report to the Committees on Appropriations of the Senate and House of Representatives in writing, on a quarterly basis, the contracts which have obligated funds under such a fixed price-type developmental contract." *Id.*

As the Court of Federal Claims explained in its initial opinion in this case, "[q]uite plainly, then, the statute has more than the Government's own interests in mind." App. at 121a. The statute "reflects a concern for sound contracting policies that encompasses the interests of *both parties – contractors* as well as the Government." *Id.* (emphasis added).

3. On December 31, 1987, very soon after § 8118 was enacted, the Navy awarded to AT&T a fixed-price research and development contract for procurement of the reduced diameter array ("RDA") system, a new detection technology for tracking ultra-quiet Soviet submarines. The opinion below confirms (as do each of the earlier opinions in this case) that "[*c*]*ontrary to that section's provisions*, the Navy awarded the RDA contract [on a fixed-price basis] without the Under Secretary of Defense for Acquisition's written determination that RDA program risk had been reduced so that realistic pricing could occur." App. at 4a (emphasis added). AT&T was not aware of DoD's violation of § 8118 at the time the RDA contract was awarded.

"The Government does not dispute that the requirements of § 8118 were not met by the Department of Defense." App. at 42a. Indeed, despite the enactment of § 8118 in 1987 and similar provisions in subsequent years' defense appropriations bills, DoD *repeatedly* and *knowingly* violated Congress' statutory prohibition by awarding, in the absence of any determination that "realistic pricing can occur," *numerous* fixed-price research and development contracts for procurement of various major military defense systems. Petitioners believe that the costs of performing those contracts have exceeded the fixed prices paid by DoD by *hundreds of millions* of dollars. Several of those procurements are now the subject of pending litigation within the Federal Circuit.

The fixed price for the RDA contract was approximately $36 million. AT&T performed the contract successfully over a period of five years. It developed, tested, and produced the RDA detection system, which the Navy then utilized to track the new generation of ultra-quiet Soviet/Russian submarines. Nevertheless, during the course of developing the RDA system, AT&T encountered numerous unforeseen technological challenges and obstacles, which caused its costs of performance to exceed the fixed contract price by at least $55 million. *See id.* at 4a; 16a-17a. Under a cost-reimbursement contract, as contemplated by § 8118, AT&T would have been compensated for those costs.

During the course of performing the fixed-price contract, AT&T advised the Navy that it was incurring huge losses. The Navy, however, showed no sympathy. For example, "[i]n order to gain some relief from this situation and to help bring costs under control, AT&T contacted the Navy in 1991 asking the procuring activity . . . not to exercise its production system options under the contract." *Id.* at 113a. In making this request, AT&T "called attention

to 'statutory restraints on the use of R&D . . . funds for fixed price contracts.' " *Id.* But the Navy turned down AT&T's request and exercised its production system options. The record indicates that the Navy took this action despite earlier being advised by the Acting Under Secretary of Defense for Acquisition that "the use of [fixed-price] production options obtained before the start of full-scale development contracts [place] excessive financial risk on contractors," and that such fixed-price research and development contracts "generally cause contractors large losses if the production options are actually exercised." Mem. from Don Yockey, Acting Under Secretary of Defense, Acquisition, to Secretaries of the Military Departments (Att: Service Acquisition Executives) (Apr. 15, 1991).

In December 1992, AT&T submitted to the Navy contracting officer a claim alleging, *inter alia*, that the Navy's use of a fixed-price contract violated § 8118. The contracting officer denied AT&T's claim in June 1993. App. at 109a-110a.

4. In August 1993, AT&T filed a Complaint against the United States in the Court of Federal Claims, citing the Tucker Act, 28 U.S.C. § 1491, and Contract Disputes Act, 41 U.S.C. §§ 601-613, as the bases for jurisdiction. AT&T alleged that as a result of the Navy's violation of § 8118, the RDA contract should be reformed from a fixed-price contract to a cost-reimbursement contract, and as a result, that it is entitled to recover its unpaid costs plus a reasonable profit. Alternatively, AT&T alleged that the contract was void at the time of the award and that it is entitled to recover on a *quantum meruit* basis under an implied-in-fact contract.

After considering the parties' cross motions for summary judgment, the court (Judge Wiese) ruled that the Navy had violated § 8118; that the resultant contract was

void *ab initio*; and that AT&T should be compensated on a *quantum meruit* basis, but that further factual development was needed to determine the appropriate amount. *AT&T I*, 32 Fed. Cl. 672 (App. at 108a). The court subsequently certified its opinion for interlocutory appeal. 33 Fed. Cl. 540 (1995) (App. at 104a).

On interlocutory appeal, the Federal Circuit panel majority (Circuit Judges Plager and Rader) agreed that § 8118 "operates as a constraint on the contracting process intended for the protection of both Government and contractor;" that DoD violated § 8118; and as a result, that the contract was void *ab initio*. *AT&T II*, 124 F.3d at 1478 (App. at 92a). The court further held that because DoD had no authority to enter into a contract that violated § 8118, AT&T was not entitled to any form of contractual relief. *Id.* Circuit Judge Newman filed a dissenting opinion, contending that the fully performed contract was not invalid. App. at 97a. The court of appeals then accepted AT&T's suggestion to rehear the appeal *en banc*, and as a result, vacated and withdrew the *AT&T II* judgment. 136 F.3d 793 (App. at 73a).

The ensuing *en banc* opinion (authored by Circuit Judge Newman and joined by Circuit Judges Clevenger, Schall, Bryson, and Gajarsa) held that although the Navy failed to comply with § 8118, that did not render the fully performed contract void *ab initio*. *AT&T III*, 177 F.3d 1368 (App. at 33a). The *en banc* plurality indicated that "[w]hen a contract or a provision thereof is in violation of law but has been fully performed, the courts have variously sustained the contract, reformed it to correct the illegal term, or allowed recovery under an implied contract theory; the courts have not, however, simply declared the contract void ab initio." App. at 48a. The opinion did not reach "the issue of what relief may be available to AT&T." *Id.* at 49a. Circuit Judge Rader, joined by Chief Judge Mayer and Circuit Judge

Lourie, filed a separate opinion concurring in the result, but contending that § 8118 did not apply to the RDA contract. *Id.* at 51a. Circuit Judge Plager filed a separate dissenting-in-part and concurring-in-part opinion, which contended that § 8118 was applicable; that DoD's violation rendered the contract invalid; but that AT&T is not entitled to any additional compensation. *Id.* at 55a.

Following remand of the case to the Court of Federal Claims, AT&T, joined by Lucent, filed an Amended Complaint, which repeated the original grounds for relief based on DoD's violation of § 8118. The Amended Complaint also included several additional theories of recovery. *See* App. at 24a. The Government then moved to dismiss for failure to state a claim upon which relief can be granted. Judge Wiese, who in *AT&T I* had found that § 8118 "encompasses the interests of . . . contractors" as well as the Government, granted the Government's motion to dismiss in *AT&T IV*, 48 F.3d 156, holding (for the first time in the litigation) that "plaintiffs cannot claim a protectable interest in the proper application of Section 8118 for Congress intended to give them none." App. at 121a; 30a.

AT&T and Lucent appealed to the Federal Circuit.

5. In *AT&T V*, 307 F.3d 1374 (App. at 1a), the court of appeals affirmed the Court of Federal Claims dismissal of the action. App. at 1a. According to the majority opinion (authored by Circuit Judge Rader and joined by Circuit Judge Prost),

> [t]he language of section 8118 *does not explicitly create a cause of action* for enforcement of its expenditure prohibitions. Instead the only explicit provision with enforcement consequences in section 8118 requires quarterly reports to the 'Committees on Appropriations . . .' Thus, *section 8118*

> *envisions enforcement, if any, through legislative procedures*. The language permits the appropriate legislative committees to monitor compliance and, presumably, guarantee enforcement in the form of future reductions in, or limitations on, appropriated funds. . . . Thus *section 8118 is an appropriations oversight provision* that envisions enforcement, if any, in the form of legislative spending adjustments in future bills. Section 8118 *does not make any provision for judicial enforcement.*
>
> * * *
>
> In sum, the language of section 8118 provides for *legislative oversight and enforcement.* The section *does not create a cause of action* inviting private parties to *enforce* the provision in courts.

Id. at 6a-8a (emphasis added). The majority indicated in the alternative that it "would be forced to conclude that AT&T waived its present arguments even were those arguments to state a valid claim." *Id.* at 11a. According to the court, "the proper time for AT&T to have raised the issues that it now presents was at the time of contract negotiation, when effective remedy was available." *Id.* at 13a.[1]

Circuit Judge Newman, who authored the Federal Circuit's earlier, *en banc* opinion, dissented to the majority opinion in *AT&T V*. She asserted that

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[1] The court also rejected, as "entirely unpersuasive," AT&T's additional allegations "that the Navy violated a variety of procurement regulations and directives that guide a contracting officer's selection of contract type." App. at 9a, 11a.

> the Court of Federal Claims [in *AT&T IV*] limited its consideration to the role of Section 8118, *despite the Federal Circuit's remand to consider the issue of relief.* This [*AT&T V*] panel also does not reach the issue of the remand. Instead, the panel majority simply restates and reexplains this court's prior ruling that violation of Section 8118 does not render a fully performed contract void *ab initio*.
>
> . . . I do not know whether this contract warrants relief. But it is *incorrect to hold that the facts are irrelevant and that there can be no relief* unless Section 8118 is enforceable by AT&T. *AT&T has not yet had its day in court*.

Id. at 18a (emphasis added).

Following issuance of the opinion below, AT&T and Lucent filed a petition for rehearing *en banc*, which the court denied. Thus, almost ten years after commencement of this litigation, and after two Court of Federal Claims opinions and three Federal Circuit opinions, AT&T and Lucent still are seeking judicial relief for the substantial financial harm they suffered as a result of DoD's undisputed violation of § 8118's prohibition against award of fixed-price research and development contracts.

REASONS FOR GRANTING THE PETITION

I. THE QUESTION PRESENTED HAS FAR-REACHING IMPLICATIONS FOR MAINTAINING THE INTEGRITY OF THE FEDERAL PROCUREMENT SYSTEM AND IS EXCEPTIONALLY IMPORTANT TO CONTRACTORS COMPRISING THE DEFENSE INDUSTRIAL BASE

The issue in this appeal is whether the Executive Branch can violate, with no judicial consequences whatsoever, a statute which mandates adherence to a significant, carefully considered, clearly articulated, congressional procurement policy – here, intended to protect contractors comprising the defense industrial base against substantial financial risks when performing research and development on major military systems. The surpassing importance of this question transcends even the vital subject of national defense procurement. It implicates the integrity of the entire federal procurement system and warrants the Court's immediate review.

The Court of Federal Claims explained in *AT&T IV* that § 8118 is a provision

> that *prohibited* the Department of Defense from either obligating or expending appropriated funds on fixed-price contracts involving the acquisition of major systems or sub-systems in excess of $10 million, absent a determination in writing that "program risk has been reduced to the extent that *realistic pricing* can occur, and that the contract type permits an *equitable* and *sensible* allocation of program risk between the contracting parties."

App. at 22a-23a (emphasis added). The court further explained that "[a]lthough the contract that the Navy awarded to AT&T in 1987 came within the scope of Section 8118 . . . the determination required by the statute was never made." *Id.* at 23a. As indicated above, DoD's violation of § 8118's prohibition against award of fixed-price research and development contracts ultimately cost AT&T more than $55 million. In *AT&T III*, the *en banc* court of appeals remanded the case to the Court of Federal Claims for a determination regarding the appropriate form of contractual relief to which AT&T is entitled. *See* App. at 34a; *see also id.* at 18a (Newman, J., dissenting) (discussing "the Federal Circuit's remand to consider the issue of relief"). Now, in *AT&T V*, the court of appeals has reversed itself by holding that Petitioners have failed to state a claim upon which relief can be granted. App. at 1a.

Unfortunately, DoD's failure to comply with § 8118 in connection with award of the RDA contract to AT&T was not an isolated occurrence. There are at least three other suits against the United States pending in the Court of Federal Claims, where other defense contractors collectively are seeking to recover almost a *billion* dollars in contract losses on the ground that DoD violated § 8118 (or its successors) to their financial detriment by utilizing fixed-price research and development contracts for procurement of major military systems. *See Short Bros., PLC v. United States*, No. 98-894C (filed Nov. 25, 1998) (involving research and development of Army National Guard aircraft); *Northrop Grumman Corp. Military Aircraft Div. v. United States*, No. 96-760C (filed Dec. 2, 1996) (involving research and development of a multiservice attack missile); *CTA Inc. v. United States*, No. 96-113C (filed Feb. 23, 1996) (involving research and development of a simulator system for Air Force navigational training) (the CTA case is being held in abeyance pending the outcome of the *AT&T* appeal).

There also are other pending cases against the United States where a contractor claims that it is entitled to contractual relief based on a DoD violation of a statute or regulation that governs material contract terms. For example, in *Gould, Inc. v. United States*, No. 95-88C (Fed. Cl. filed Feb. 12, 1988), the contractor claims that it is entitled to reformation of a multi-year contract that provided for research and development of radios meeting certain Navy performance specifications. The contractor, which is seeking tens of millions of dollars in monetary relief, contends that in awarding the contract, the Navy violated a 1982 procurement statute, 10 U.S.C. § 2306(h)(1)(D) (1982), by failing to provide a "stable design" for the radios. The litigation has been pending for many years. Nevertheless, on April 4, 2003 the Government filed a cross-motion for summary judgment arguing – based on the *AT&T* opinion below – that "the Federal Circuit unquestionably has established the principle that funding statutes . . . are not judicially enforceable by contractors." Defendant's Cross-Motion for Summary Judgment at 13, *Gould* (No. 95-88C). According to the Government, "[t]here is *no material distinction between the statutes in Gould and AT&T*." *Id.* (emphasis added). Thus, in its recent brief in *Gould*, the Government argues the Federal Circuit's opinion below has broad applicability, and implicitly acknowledges that the statutory "enforceability" issue is squarely presented by the *AT&T* case.

If the opinion below is allowed to stand, the adverse consequences for both the defense industrial base and the federal procurement system will be profound. DoD will interpret the opinion as giving it free reign to violate, whenever in its economic interests to do so, mandatory statutory requirements or prohibitions which Congress has determined are needed to preserve the defense industrial base. At the very least, unless the opinion is reversed, the

integrity of congressional procurement policies, and the credibility of DoD as a contracting party, would be seriously undermined. Indeed, one of the very reasons why Congress enacted § 8118 was "*to maintain the government's credibility* as a reliable business partner." H.R. Conf. Rep. No. 100-498, at 623 (1987) (emphasis added). Yet, Congress has observed that DoD has continued to exhibit an unmistakable pattern of noncompliance with statutory, procurement-related requirements and prohibitions. *See, e.g.*, H.R. Rep. No. 106-244, at 8, 10 (1999) (expressing, in connection with the Department of Defense Appropriations Bill of 2000, the House Appropriations Committee's concern for "ensuring that funds made available in appropriations acts are in fact put to the use intended by the elected members of Congress, *under the terms and conditions the Congress and the House and Senate Appropriations Committees place on the funding in question*," and asserting that "the Committee simply *cannot excuse violations of appropriations and acquisition law, regulation and practice*") (emphasis added).

Depriving aggrieved contractors of all judicial remedies when a federal department or agency violates a statutory or regulatory, contract-related requirement or prohibition, especially where, as here, it was enacted for the protection of contractors (as well as the Government), would be a powerful disincentive for doing business with the Government. This is particularly true in connection with long-term, high financial risk, research and development necessary for the national defense. The resultant decrease in competition for such work may impede government access to new technologies and drive contract prices higher.

Moreover, where, as here, the Government's violation subsequently causes a contractor to incur a substantial financial loss, both the contractor and the

Government are harmed. *See, e.g., Better Acquisition Outcomes Are Possible if DOD Can Apply Lessons from F/A-22 Program*, 108th Cong. 16 (2003) (Statement of David M. Walker, Comptroller General of the United States, House Comm. on Government Reform) (discussing DoD's "high risk [procurement] approach whose outcomes so far have been increased cost, quality and reliability problems, growing procurement reductions, and delays"). As Eleanor R. Spector, former Deputy Assistant Secretary of Defense for Procurement, explained when asked about cost overruns caused by fixed-price research and development contracts, "[i]t *hurts our industrial base* . . . It's *not a fair way* to treat our contractors." David F. Bond, *Defense Contractors Industry Controls Effort, Costs In Fixed-Price Development Losses*, Aviation Week & Space Technology, Sept. 3, 1990, at 179 (emphasis added). Yet, the record of this case includes an internal DoD memorandum, provided to Ms. Spector to help her prepare for the interview leading to the cited *Aviation Week* article, which advised her that "use [of] cost-type contracts for complex major weapon system development efforts [was] *never enforced* in a specific program." Mem. from Charles Zuckerman to Eleanor Spector (July 5, 1990) (emphasis added).

Each of the Federal Circuit and Court of Federal Claims opinions rendered in this case confirms that DoD violated § 8118 by awarding the RDA contract to AT&T on a fixed-price basis.[2] DoD's indisputable violation makes this

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[2] *See AT&T V*, App. at 4a ("Contrary to [§ 8118's] provisions, the Navy awarded the RDA contract . . . ."); *AT&T IV*, App. at 30a (discussing the Navy's "non-compliance with the statute"); *AT&T III*. App. at 43a (discussing the "question of the consequences of this failure of compliance by the Department of Defense"); *AT&T II*, App. at 80a ("No valid contract was or could be entered into in

(Footnote cont'd on next page.)

a perfect vehicle for the Court to resolve the question of whether traditional contractual remedies are available to aggrieved government contractors when federal departments or agencies violate statutory requirements or prohibitions that govern material contract terms.

II. REVIEW IS NEEDED TO RESTORE CLARITY AND CONSISTENCY REGARDING THE AVAILABILITY OF CONTRACTUAL REMEDIES WHEN A FEDERAL DEPARTMENT OR AGENCY VIOLATES A STATUTORY OR REGULATORY REQUIREMENT GOVERNING MATERIAL CONTRACT TERMS

According to the majority opinion below, the absence of an explicit right of action in § 8118, coupled with the statute's ancillary reporting ("congressional oversight") clause, deprives Petitioners of all contractual remedies, despite the tens of millions of dollars that AT&T lost as a result of DoD's violation of the statute. *See* App. at 16a-17a. The majority opinion not only is erroneous, but also appears to create a *broad, new principle* that is patently inconsistent with a long line of Federal Circuit cases granting relief to contractors aggrieved by illegal contract terms or contracts. Indeed, in its earlier, *en banc* opinion, the court of appeals explicitly *relied* on that same precedent. The court explained that "[w]hen a contract or a provision thereof is in *violation of law* but has been fully performed, the courts have

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(Footnote cont'd from previous page.)

the face of the express congressional prohibition."); *AT&T I*, App. at 126a-127a ("The action taken by the Department of Defense is contrary to the clearly expressed intent of Congress and is therefore contrary to law.").

variously sustained the contract, *reformed it to correct the illegal term*, or *allowed recovery under an implied contract theory*." *Id.* at 16a (collecting cases) (emphasis added).

No prior case has held that an authorization, appropriations, or other procurement-related statute (or regulation) must contain an explicit right of action in order for a contractor to be entitled to such traditional contractual remedies where, as here, a federal department or agency violates the statute's requirements or prohibitions relating to material contract terms (e.g., pricing terms). For example, in *Gould, Inc. v. United States*, 67 F.3d 925 (Fed. Cir. 1995), the contractor sought compensation based on an implied-in-fact contract theory. The Federal Circuit rejected, for the second time, the Government's contention that the contractor failed to state a claim upon which relief can be granted. As indicated above, the case has returned to the Court of Federal Claims, and the Government now is seeking summary judgment based on *AT&T*.

Similarly, in *Urban Data Systems, Inc. v. United States*, 699 F.2d 1147 (Fed. Cir. 1983), the Federal Circuit affirmed a General Services Administration Board of Contract Appeals ruling that a contract was invalid because the Small Business Administration had violated a statutory prohibition against cost-plus-percentage-of-cost contracts. The court of appeals agreed that the contractor "is entitled to reimbursement on a *quantum valebant* basis" under an implied-in-fact contract. *Id.* at 1154. The pertinent procurement statutes did not include an explicit right of action. Other precedent allowing recovery under implied contracts to redress Government violations of procurement statutes or regulations, despite the absence of an explicit statutory right of action, includes *Barrett Refining Corp. v. United States*, 242 F.3d 1055, 1060 (Fed. Cir. 2001) ("Given that the price escalation clause was unauthorized and

unenforceable, we agree with the Court of Federal Claims' implicit legal conclusion that there was . . . nothing to preclude an implied-in-fact agreement on that term."); *New England Tank Industries of New Hampshire, Inc. v. United States*, 861 F.2d 685, 694-95 (Fed. Cir. 1988) (recognizing claim based on violation of funding regulation); *United States v. Amdahl Corp.*, 786 F.2d 387, 395 (Fed. Cir. 1986) (recognizing entitlement under an implied-in-fact contract based on violation of a procurement statute prohibiting advance payments); *see also Clark v. United States*, 95 U.S. 539, 541-42 (1877) (allowing recovery against the United States for *quantum meruit* under an implied contract where the Government violated the statute of frauds' requirement that contracts be in written form).

There also is a long line of cases which, despite the absence of an explicit statutory right of action, have provided equitable relief to aggrieved contractors by reforming otherwise legal contracts to add or change contract clauses where the Government has violated procurement statutes or regulations. For example, in *LaBarge Products, Inc. v. West*, 46 F.3d 1547, 1552 (Fed. Cir. 1995), the Federal Circuit recognized "the equitable principle of contract reformation when a contract has been written in violation of a law or regulation enacted for the benefit of prospective contractors." Similarly, in *Beta Systems, Inc. v. United States*, 838 F.2d 1179, 1186 (Fed. Cir. 1988), the court of appeals explained that if a contract violates procurement regulations, "then reformation is appropriate." *See also Cessna Aircraft Co. v. Dalton*, 126 F.3d 1442, 1447 (Fed. Cir. 1997) (citing *LaBarge Products, Inc.*); *Applied Devices Corp. v. United States*, 591 F.2d 635, 640-41 (Ct. Cl. 1979) (holding that the contractor was entitled to reformation because the contract violated regulations governing cancellation ceilings that were adopted to protect contractors); *Chris Berg, Inc. v. United States*, 426 F.2d 314,

317-18 (Ct. Cl. 1970) (holding that the contractor was entitled to reformation of the contract price because the Government violated certain regulations that were adopted to protect contractors); *see generally G. L. Christian & Assoc. v. United States*, 312 F.2d 418 (Ct. Cl. 1963) (indicating that the court will reform government contracts by incorporating into them clauses that are required by law).

Yet, the seeming new legal principle announced by the Federal Circuit in this case is that a government contractor aggrieved by an Executive Branch violation of a contract-related requirement or prohibition contained in a procurement statute is not entitled to judicial relief unless the statute also includes an explicit right of action, even where, as here, the statute is intended to protect the contractor as well as the Government. This holding suddenly and unavoidably casts a broad, dark shadow of doubt across the body of federal common law precedent involving judicial relief for illegal contracts or contract terms (such as illegal pricing terms).

For example, in a recent Armed Services Board of Contract Appeals ("ASBCA") case, a contractor sought, *inter alia*, reformation of a contract from "firm-fixed price" to "total cost." *Appeals of Randolph & Co., Inc.*, ASBCA Nos. 52953-52959, 2002 WL 31501912 (Nov. 6, 2002). In its decision, the ASBCA indicated that "for legal authority, [the contractor] cites *LaBarge Products, Inc.*," *supra*, and other cases. *Id.* But the ASBCA further indicated that based on the Federal Circuit's opinion in *AT&T V*, "there is no basis here for equitable reformation." *Id.* In denying the contractor's motion for reconsideration, the ASBCA explained that "[i]t was not necessary to analyze appellant's argument more closely given the *authoritative and dispositive nature* of the cited [*AT&T V*] court decision." *Appeals of Randolph & Co., Inc.*, ASBCA Nos. 52953-

52959, 2003 WL 139510 (Jan. 13, 2003); *see also Information Tech. & Applications Corp. v. United States*, 316 F.3d 1312, 1323 (Fed. Cir. 2003) (discussing *AT&T V*); *C.W. Over & Sons, Inc. v. United States*, 54 Fed. Cl. 514, 522 (2002) (same).

Thus, the opinion below, which has the potential for eroding the defense industrial base upon which the Government and the public so heavily depend, already has commanded deferential treatment. *See generally* R. Stern, E. Gressman, S. Shapiro & K. Geller, Supreme Court Practice 264, 265 (8th ed. 2002) (explaining that because of the Federal Circuit's exclusive jurisdiction over claims "involving many of the legal obligations of the United States . . . [t]he issues arising in this type of litigation . . . can have a *special importance* that warrants review by the Supreme Court," and that "the decisions of the Federal Circuit . . . *alone* often settle the law in the absence of Supreme Court review") (emphasis added).

Further, as discussed above, there are additional pending cases in which contractors are seeking contractual remedies and hundreds of millions of dollars in relief from the United States on the ground that DoD violated § 8118 or other procurement statutes requiring or prohibiting particular contract terms. The Government has been using the opinion below aggressively in seeking to deprive such contractors of judicial remedies. For these reasons, there is a *pressing need* for restoration of clarity and consistency within the Federal Circuit, the Court of Federal Claims, and boards of contract appeals, which only the Supreme Court can provide.

The immediate need for Supreme Court review also is underscored by the *patently contradictory manner* in which this case itself has been handled by both the Federal Circuit and Court of Federal Claims over the course of the

past decade. For example, in *AT&T I*, the trial court unequivocally found that § 8118 "[q]uite plainly . . . has more than the Government's own interests in mind," and that the statute "encompasses the *interests of . . . contractors* as well as the Government." App. at 121a (emphasis added). The *AT&T II* opinion (superseded by *AT&T III*) expressly affirmed this conclusion. *See* App. at 90a. But in *AT&T IV* (affirmed by the *AT&T V* opinion below), the same trial court inexplicably found that Petitioners cannot state a claim upon which relief can be granted, in part on the ground that they "*cannot claim a protectable interest* in the proper application of Section 8118 for Congress intended to give them none." *Id.* at 30a (emphasis added).

Along the same lines, in *AT&T III*, the *en banc* court of appeals specifically acknowledged the ample case law granting relief in the form of reformation to correct illegal contract terms or *quantum meruit* recovery under an implied contract, and remanded the case for a determination as to the contractual relief to which Petitioners are entitled in view of the Navy's violation of § 8118. *Id.* at 48a-49a. But in the *AT&T V* opinion below, the panel majority (over the strong dissent of Circuit Judge Newman, who wrote the earlier, *en banc* opinion) affirmed the trial court's ruling in *AT&T IV* that despite the Navy's violation of § 8118, the Petitioners cannot state a claim upon which relief can be granted. *Id.* at 14a.

To compound this inconsistency and confusion, the author of the opinion now at issue has repeatedly changed his position during the course of the litigation. He joined in *AT&T II*'s majority holding that § 8118 was intended to protect both contractors and the Government; that § 8118 *applied* to the RDA contract; and that the contract was void *ab initio* because of DoD's violation of the statute. Then, in *AT&T III*, he filed a separate opinion contending that § 8118

is *inapplicable* to the contract. Now, in *AT&T V*, he has opined that although § 8118 *is* applicable to the contract and DoD violated the statute in awarding the contract, Petitioners are not entitled to judicial relief because they have no protectable interest.

These and other judicial perturbations in this litigation provide another compelling reason for the Court's review.

III. THE FEDERAL CIRCUIT'S HOLDING IS CLEARLY ERRONEOUS

Besides creating a new principle which directly conflicts with the Federal Circuit's own precedent, the majority opinion's legal analysis is patently incorrect.

First, the opinion is predicated upon a *fundamental mischaracterization* of Petitioners' suit, which is *not* for "enforcement" of § 8118. The opinion speculates that Congress, through monitoring and oversight, might have been able to "guarantee enforcement in the form of *future* reductions in, or limitations on, appropriated funds." App. at 6a (emphasis added). Petitioners, however, are not attempting to usurp that legislative function. Nor are they attempting to act as private attorneys general seeking to compel future compliance with a statutory prohibition which both the Federal Circuit and Court of Federal Claims squarely held DoD violated *sixteen years ago*. Instead, Petitioners are aggrieved contractors which seek traditional contractual remedies and monetary relief for the harm caused by DoD's egregious violation of § 8118's prohibition against fixed-price research and development contracts.

Thus, the premise of the opinion below, that "section 8118 envisions *enforcement*, if any, through legislative

procedures," is *wholly irrelevant* to Petitioners' claim. *Id.* at 6a (emphasis added). Legislative "enforcement" of a statutory prohibition through congressional oversight and prospective legislation, and judicial relief necessitated by a federal department's prior violation of the same statutory prohibition, are not mutually exclusive. Also, the ancillary requirement in § 8118 that DoD provide reports to congressional appropriations committees regarding contracts which DoD determined *qualified* for the limited statutory exception to the statutory prohibition against fixed-price contracts, belies the majority opinion's notion that § 8118 provided for legislative "enforcement." This is because the reports required by § 8118 assume *compliance* with the statute's exception for situations where "realistic pricing can occur." Where, as here, DoD *violates* the statute, nothing in § 8118 would trigger congressional reporting or oversight, or legislative enforcement.

Furthermore, the majority opinion's interpretation of § 8118 unjustifiably relies upon a *post hac* "legislative history" statement from a 1988 report issued by the Senate Armed Services Committee (even though the House Appropriations Committee was responsible for drafting § 8118) to support the proposition that the statute should "not be used as the basis for litigating the propriety of an otherwise valid contract." App. at 8a (citing S. Rep. No. 100-326, at 105 (1988)). As Circuit Judge Plager discussed in his separate opinion in *AT&T III*, however, "this so-called legislative history is not history" since it appeared in a report that was "written *after* § 8118 was enacted in 1987, and relate to *later-considered* legislation." App. at 62a (Plager, J., dissenting in part and concurring in part) (emphasis partially in original). "How the views of a later Congress, not contained in actual legislation, can be seen as amending or modifying prior legislative acts, is not explained." *Id.* at 62a-63a; *see generally Cipollone v. Liggett Group, Inc.*, 505

U.S. 504, 520 (1992) (" 'the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one' ") (quoting *United States v. Price*, 361 U.S. 304, 313 (1960)).

Moreover, as Circuit Judge Plager explained, "when examined, even the terms in which the language of the 1988 Senate Report was written . . . fail to support the court's view." App. at 63a. For example, "the very next sentence in the [Senate] Report is 'Nothing in this section shall be construed to affect the requirements of section 8118 of the Department of Defense Appropriations Act, 1988.' " *Id.* Instead, "[t]he only consistent thread in [the legislative history] is the expression of *congressional irritation and frustration with the DoD's (or at least the Navy's) stubborn insistence on doing what Congress wanted stopped*" (i.e., awarding fixed-price research and development contracts). *Id.* (emphasis added).

Second, the panel majority's alternative discussion on waiver is erroneous as a matter of law. This Court long has held that an illegality in a contract generally cannot be waived. *See Kaiser Steel Corp. v. Mullins*, 455 U.S. 72, 81 n.6 (1982); *McMullen v. Hoffman*, 174 U.S. 639, 658 (1899). The rationale underlying these decisions is that neither courts nor contracting parties have the right to waive a requirement imposed by law. Indeed, the cases cited by the *en banc* majority in *AT&T III* confirm this well established principle. App. at 48a (citing *LaBarge*, 46 F.3d at 1552-53 and *Beta Systems*, 838 F.2d at 1185). Further, as Circuit Judge Newman indicated in her dissent in *AT&T V*, the majority opinion's discussion regarding AT&T's supposed "waiver" of its arguments is based on "speculative theories [not] developed in the record." App. at 17a (Newman, J., dissenting).

The majority opinion below asserts that "this court is not inclined to change the rules and the scoring after the game has been played." App. 12a. But one of the "game's" unequivocal rules, established by Congress, is the prohibition against DoD procuring research and development of major military systems on a fixed-price basis, unless the contract qualified for the statutory exception and the required written findings were made in advance of contract award. DoD, at the outset of the "game," utterly ignored that statutory prohibition to the subsequent financial detriment of AT&T. Now all that AT&T and Lucent are asking the lower courts to do is "score" the contract in accordance with Congress' rule by granting traditional contractual remedies, and pursuant to those remedies, by awarding appropriate monetary relief.

This Court should grant review and reverse the opinion below so that Petitioners can obtain judicial relief. Holding that government contractors can pursue contractual remedies when aggrieved by Executive Branch violations of federal procurement statutes also would restore integrity and stability to the federal procurement system, which the opinion below has seriously undermined.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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United States Court of Appeals for the Federal Circuit

01-5044

AMERICAN TELEPHONE AND TELEGRAPH COMPANY

and

LUCENT TECHNOLOGIES, INC.,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

DECIDED: October 8, 2002

Before NEWMAN, RADER, and PROST Circuit Judges.

Opinion for the court filed by Circuit Judge RADER. Dissenting opinion filed by Circuit Judge NEWMAN.

RADER, Circuit Judge.

The United States Court of Federal Claims dismissed the American Telephone & Telegraph Company's (AT&T) suit against the Navy for failure to state a claim. Because the Navy's violation of section 8118 of the Department of Defense (DoD) Act, Pub. L. No. 100-202, section 8118, 101

Stat. 1329, 1329-84 (1987), and alleged violation of various procurement regulations and directives was not a wrong actionable by AT&T, this court affirms.

I.

The Court of Federal Claims has recently added another chapter to the lengthy story of this case. Am. Tel. & Tel. Co. v. United States, 48 Fed. Cl. 156 (2000) (AT&T IV). Already the history of this case involves three earlier decisions, including an *en banc* decision of this court. Am. Tel. & Tel. Co. v. United States, 32 Fed. Cl. 672 (1995) (AT&T I); Am. Tel. & Tel. Co. v. United States, 124 F.3d 1471 (Fed. Cir. 1997) (vacated and withdrawn) (AT&T II); and Am. Tel. & Tel. Co. v. United States, 177 F.3d 1368 (Fed. Cir. 1999) *(en banc)* (AT&T III). In addition, the certification of the interlocutory appeal from AT&T I is reported at 33 Fed. Cl. 540 (1995).

In AT&T III, this court held *en banc* that the Navy's violation of section 8118 did not void the Navy's contract with AT&T. That opinion recites in detail the relevant facts of this case. For convenience, this court briefly restates the relevant background.

Section 8118 states:

> None of the funds provided for the Department of Defense in this Act may be obligated or expended for fixed price-type contracts in excess of $10,000,000 for the development of a major system or subsystem unless the Under Secretary of Defense for Acquisition determines, in writing, that program risk has been reduced to the extent that realistic pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties: Provided, That the Under Secretary may not delegate this authority to any persons who hold a position in the Office of the Secretary of Defense below the level of Assistant Under Secretary of Defense: Provided further, That the

> Under Secretary report to the Committees on Appropriations of the Senate and House of Representatives in writing, on a quarterly basis, the contracts which have obligated funds under such a fixed price-type developmental contract.

Id. (emphases added).

During the 1980s, the Navy sought to develop detection technology for tracking ultra-quiet submarines of the Soviet Union. As part of an integrated sonar system, the Navy solicited bids for the reduced diameter array (RDA). AT&T bid for the RDA contract on a fixed-price basis against competitors that the Navy judged more technically competent. On December 31, 1987, the Navy awarded AT&T the RDA contract based on the substantially reduced price of its best and final offer (BAFO). In a bid protest, one of AT&T's competitors challenged that price as erroneous. Gould, Inc., Ocean Sys. Div., B-229965, 88-1 CPD ¶ 457 (May 16, 1988). AT&T retained the RDA contract in a vigorous bid defense. Id. AT&T eventually performed the RDA contract at a cost of over $91 million, greatly in excess of the contract's adjusted final price of about $34.5 million.

The Navy awarded the RDA contract to AT&T as a fixed-price contract just nine days after enactment of section 8118. Contrary to that section's provisions, the Navy awarded the RDA contract without the Under Secretary of Defense for Acquisition's written determination that RDA program risk had been reduced so that realistic pricing could occur.

This court held *en banc* that violation of section 8118 did not render the contract void ab initio:

> Both the DoD administration of § 8118, and the congressional response to this administration,

> make clear that Congress did not intend that this enactment would terminate fully performed contracts because of this flawed compliance.

AT&T III, 177 F. 3d at 1375. Therefore, the *en banc* court remanded to the Court of Federal Claims to determine what remedy, if any, was available to AT&T for the Navy's violation of section 8118. In a well-reasoned opinion, the Court of Federal Claims held that "non-compliance with [section 8118] is not an actionable wrong. . . . [P]laintiffs cannot claim a protectable interest in the proper application of Section 8118 for Congress intended to give them none." AT&T IV, 48 Fed. Cl. at 160. The Court of Federal Claims also found that federal regulations and DoD directives did not remove the contracting officer's discretion to negotiate the RDA contract on a fixed-price basis. For these reasons, the Court of Federal Claims dismissed AT&T's complaint for failure to state a claim upon which relief could be granted. AT&T has sought reformation of its contract with the Navy. This court has jurisdiction under 28 U.S.C. § 1295(a)(3) (2000).

II.

This court reviews the Court of Federal Claims' conclusions of law, such as contract or statutory interpretation, without deference. Mass. Bay Transp. Auth. v. United States, 254 F.3d 1367, 1372 (Fed. Cir. 2001). This court also reviews without deference the Court of Federal Claims' dismissal for failure to state a claim upon which relief can be granted. Southfork Sys., Inc. v. United States, 141 F.3d 1124, 1131 (Fed. Cir. 1998). This court sustains the Court of Federal Claims' fact finding unless "clearly erroneous." City of El Centro v. United States, 922 F.2d 816, 819 (Fed. Cir. 1990).

A.

This court must again consult the meaning of section 8118. Mobil Oil Corp. v. Higginbotham, 436 U.S. 618, 626 (1978) ("[Courts] have no authority to substitute [their] views for those expressed by Congress in a duly enacted statute."). The language of section 8118 does not explicitly create a cause of action for enforcement of its expenditure prohibitions. Instead the only explicit provision with enforcement consequences in section 8118 requires quarterly reports to the "Committees on Appropriations of the Senate and the House of Representatives in writing." Thus, section 8118 envisions enforcement, if any, through legislative procedures. The language permits the appropriate legislative committees to monitor compliance and, presumably, guarantee enforcement in the form of future reductions in, or limitations on, appropriated funds. Indeed, appropriation bills often contain this kind of oversight provision that permits the appropriation committees to properly monitor federal spending programs. Department of Defense Appropriations Act, 2000, Pub. L. No. 106-79, § 8075, 113 Stat. 1212, 1246-47 (1999) ("[T]he Secretary of Defense may issue loan guarantees in support of United States defense exports . . . [p]rovided . . . [t]hat the Secretary shall provide quarterly reports to the Committee on Appropriations."); Department of Defense Appropriations Act, 1999, Pub. L. No. 105-262, § 8075, 112 Stat. 2279, 2314 (1998); see also Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999, Pub. L. No. 105-276, § 414, 112 Stat. 2461, 2509 (1998) ("None of the funds . . . shall be used to enter into any new lease . . . unless the Secretary submits, in writing, a report to the Committee on Appropriations of the Congress."). Based on that oversight, the committees and Congress can then adjust the spending allotments in future bills to ensure compliance with legislative

objectives. Thus section 8118 is an appropriations oversight provision that envisions enforcement, if any, in the form of legislative spending adjustments in future bills. Section 8118 does not make any provision for judicial enforcement.

As already noted, this court held *en banc* that section 8118 does not "terminate fully performed contracts because of [DoD's] flawed compliance." AT&T III, 177 F.3d at 1374-75. For that reason, the en *banc* court held that the Navy's "noncompliance with the supervisory and reporting instructions" in section 8118 did not render the RDA contract void. Id. at 1375 (citing Longshore v. United States, 77 F.3d 440, 443 (Fed. Cir. 1996)). Instead, this court emphasized the "supervisory" role of the legislative branch in ensuring compliance with the policies of section 8118. More specifically, in AT&T III, this court held that section 8118 functions as an "internal review and reporting procedure[]" for congressional oversight. Id. at 1376.

Indeed congressional response to DoD's flawed administration of section 8118 confirms this meaning of the statutory language. Following enactment of section 8118, Congress was apparently dissatisfied with DoD's initial compliance with that section. Id. at 1374. In response, subsequent legislation tightened that section's reporting provisions to require before-award reports rather than after-the-fact quarterly reports. Id. Again, before-award reports would permit Congress to respond with funding reductions or limitations in appropriations bills. In considering enactment of those stricter reporting provisions, the Senate Armed Services Committee stated expressly that noncompliance with section 8118 should not be "the basis for litigating the propriety of an otherwise valid contract":

> The committee recognizes that there are circumstances in which fixed-price development contracts are appropriate (e.g., when costs and foreseeable program risks can be reasonably anticipated), and the committee expects the Department to establish clear guidelines under this section for use of such contracts.
>
> It is the intent of the committee that this section be applied in a manner that best serves the government's interests in the long term health of the defense industry, and that this section not be used as the basis for litigating the propriety of an otherwise valid contract.

S. Rep. No. 100-326., 100th Cong., 2d Sess. at 105 (1988) (emphasis added). This court en *banc* gave significant weight to this statement of one Senate committee. AT&T III, 177 F.3d at 1375 ("This explicit statement of intent weighs heavily against judicial invalidation of 'an otherwise valid contract,' for the clearly stated congressional purpose is contrary.").

In sum, the language of section 8118 provides for legislative oversight and enforcement. The section does not create a cause of action inviting private parties to enforce the provision in courts. In that context, AT&T's suit for reformation presumes to undertake a challenge as a private party to the propriety of the otherwise valid RDA contract. AT&T's earlier attack on that contract's validity similarly presumed to undertake Congress's role as the enforcement mechanism for section 8118. Section 8118, however, does not permit this form of enforcement. As this court *en banc* refused to void the otherwise valid and performed RDA contract, so this court again acknowledges as correct the trial court's refusal to entertain AT&T's request for contract reformation.

Section 8118 simply does not provide implicitly or explicitly for any enforcement of its supervisory and congressional oversight provisions in a judicial forum.

This result finds further support in separation of powers principles. As the *en banc* court noted, it is not "the judicial role to discipline the agency's noncompliance with the supervisory and reporting instructions of congressional oversight." Id. at 1375. The Supreme Court itself has acknowledged spheres of exclusive congressional oversight:

> "It is always easy to conjure up extreme and even oppressive possibilities in the exertion of authority. But courts are not charged with general guardianship against all potential mischief in the complicated tasks of government. The present case makes timely the reminder that 'legislatures are ultimate guardians of the liberties and welfare of the people in quite as great a degree as the courts.' Missouri, Kansas & Texas Ry. Co. v. May, 194 U.S. 267, 270, 24 S.Ct. 638, 639, 48 L.Ed. 971. Congress which creates and sustains these agencies must be trusted to correct whatever defects experience may reveal."

Federal Communications Comm'n v. Pottsville Broad. Co., 309 U.S. 134, 146 (1940).

AT&T also alleges that the Navy violated a variety of procurement regulations and directives that guide a contracting officer's selection of contract type. See, e.g., 48 C.F.R. §§ 16.104, 35.006, 216.101, 216.104 (1987); DoD Directive 5000.1 (Sept. 1, 1987). Those regulations and directives grant the contracting officer the discretion to select the type of contract. See, e.g., 48 C.F.R. § 35.006(b) (Stating that "[s]electing the appropriate contract type is the responsibility of the contracting

officer."); 48 C.F.R. § 16.103(a) ("Selecting the contract type is generally a matter for negotiation and requires the exercise of sound judgment."); 48 C.F.R. § 16.104 (Stating that "[t]here are many factors that the contracting officer should consider in selecting and negotiating the contract type . . . ."); cf. 10 U.S.C. § 2306(a) (1982) (An agency head generally "may . . . make any kind of contract that he considers will promote the best interests of the United States."). Moreover, in a negotiated procurement, as in this case, this court has held that the regulations entrust the contracting officer with especially great discretion, extending even to his application of procurement regulations. Labarge Prods. v. West, 46 F.3d 1547, 1555 (Fed. Cir. 1995); see also Burroughs Corp. v. United States, 617 F.2d 590, 597-98, 223 Ct. Cl. 53, 65 (1980).

In spite of contracting officers' generally broad discretion, AT&T argues that the procurement regulations and directives prohibited this contracting officer from negotiating the RDA contract on a fixed-price basis. Those provisions cautioned against a fixed-price contract where substantial developmental risk renders cost estimation merely hypothetical. See, e.g., 48 C.F.R. § 216.104 (1987); 48 C.F.R. § 35.006(c) (1987). A caution, however, is not a prohibition. In fact, the regulations also admonished: "When the use of cost and performance incentives is desirable and practicable, fixed price incentive . . . contracts should be considered." 48 C.F.R. § 35.006(c) (1987). In short, "selection of the appropriate contract type is, in the final analysis, the responsibility of the contracting officer," 48 C.F.R. § 216.104(1) (1987), subject to his good discretion.

Even if the contracting officer abused his discretion by negotiating the RDA contract on a fixed-price basis -- a finding which the trial court properly declined to make on this record -- that finding still would

not provide AT&T a remedy. These cautionary and informative regulations and directives provide only internal governmental direction. Like section 8118, these provisions supply no remedy for private parties in a judicial forum. Cf. Thompson v. Thompson, 484 U.S. 174, 188-92 (1988) (Scalia, J., concurring) ("[T]his Court has long since abandoned its hospitable attitude towards implied rights of action . . . . The recent history of our holdings is one of repeated rejection of claims of an implied right."). As this court's predecessor stated: "[T]he fact that a procurement practice is prohibited does not necessarily mean that it is therefore actionable. The discipline to be administered in such cases is a responsibility of the cognizant procurement officials within the agency . . . [and not] by this court." E. Walters & Co. v. United States, 576 F.2d 362, 367 (Ct. Cl. 1978).

AT&T presents also a variety of unsupported legal theories to support its claim. This court has considered those arguments and finds them entirely unpersuasive. In sum, this court holds that the district court did not err in holding that AT&T failed to state a valid claim under section 8118, the regulations and directives, or any other legal theory.

B.

In view of the facts of this case, this court would be forced to conclude that AT&T waived its present arguments even were those arguments to state a valid claim. At the time it negotiated the RDA contract, AT&T was fifteenth among the Top 100 Federal Contractors, having 1,438 procurement actions worth over $2 billion. AT&T III, 177 F.3d at 1383 (PLAGER, J., dissenting). As a sophisticated player, AT&T bargained for and won a fixed-price contract - with all of its attendant benefits and risks. Despite AT&T's sophistication on these matters, the record simply provides

no evidence that AT&T sought a cost reimbursement contract during contract negotiations.

As this court previously noted, AT&T successfully underbid technically superior competitors to win the RDA contract, and retained the contract with a vigorous defense against a competitor's protest action. Nonetheless, AT&T now argues that the courts must relieve it of the risk that it so aggressively pursued. It is too late now to make that claim.

The reformation that AT&T seeks is not minor, but strikes to the core of the contract bargain. In the fixed-price contract, for example, AT&T agreed, in essence, to assume the risk associated with its lower technical rating. Had the contract required cost-reimbursement, however, the Navy would have assumed the risk that AT&T's inferior technical capability would result in more costly performance. Under a cost-reimbursement scheme, this court perceives that the Navy may have refused to assume the risk of AT&T's technical competency. Instead, the Navy might have avoided that risk by awarding the RDA contract to one of AT&T's technically superior competitors - a contingency of which AT&T surely was aware. In sum, competition on a cost-reimbursement basis may have taken AT&T out of the game. In any event, this court is not inclined to change the rules and the scoring after the game has been played.

Moreover, in a cost-reimbursement contract, the Government retains the right to minimize its risk by supervising closely the contractor's performance. By performing the RDA contract on a fixed-price basis, AT&T avoided the costs of more intrusive government supervision. These tradeoffs between Government oversight and contractor autonomy are fundamental to any agreement on price or contract type. Moreover,

unlike money, these bargained for rights are not reallocable after performance. The FAR provides: "Negotiating the contract type and negotiating prices are closely related and should be considered together." 48 C.F.R. § 16.103(a) (1987). Contract reformation now, after full performance, would impose upon the Navy the full cost of performance at a time when the quid pro quo of a cost-reimbursement bargain, e.g., the right to supervise, is moot. Reformation here, simply put, would not further the mutual intent of the parties. See Atlas Corp. v. United States, 895 F.2d 745, 750-51 (Fed. Cir. 1990) ("Reformation serves to bring the parties' written contract in accord with their agreement."); Am. President Lines, Ltd. v. United States, 821 F.2d 1571, 1582 (Fed. Cir. 1987) ("The purpose and function of the reformation of a contract is to make it reflect the true agreement of the parties on which there was a meeting of the minds.").

Additionally, reformation of the RDA contract would cure the Navy's section 8118 noncompliance only at the expense of creating non-compliance with other statutory and regulatory provisions. Specifically, in 1987, 10 U.S.C. § 2306 essentially mirrored section 8118's certification requirements. Section 2306 expressly prohibited contracting officers from negotiating cost-reimbursement contracts without the agency head's certification that no lower cost alternative existed. 10 U.S.C. § 2306 (1982); see also FAR 16.301-3(c) (1987). As a result, reformation of the RDA contract to avoid noncompliance with section 8118 eliminates one hydra head only to raise another.

In short, the proper time for AT&T to have raised the issues that it now presents was at the time of contract negotiation, when effective remedy was available. This, AT&T did not do. For reasons evident above, even were AT&T to have stated a valid claim for reformation, this court's case law would require a finding that AT&T waived

that claim. Whittaker Elec. Sys. v. Dalton, 124 F.3d 1443, 1446 (Fed. Cir. 1997) ("The doctrine of waiver precludes a contractor from challenging the validity of a contract, whether under a DAR [defense acquisition regulation] or on any other basis, where it fails to raise the problem prior to execution, or even prior to litigation, on which it later bases its challenge.") (citing United Int'l Investigative Servs. v. United States, 109 F.3d 734, 738 (Fed. Cir. 1997); E. Walters & Co., 576 F.2d at 367-68).

CONCLUSION

In sum, AT&T does not have an enforceable interest in section 8118 or the asserted procurement regulations and directives. This court, therefore, affirms.

COSTS

Each party shall bear its own costs.

AFFIRMED

United States Court of Appeals for the Federal Circuit

01-5044

AMERICAN TELEPHONE AND TELEGRAPH COMPANY

and

LUCENT TECHNOLOGIES, INC.,

Plaintiffs-Appellants

v

UNITED STATES,

Defendant-Appellee.

NEWMAN, Circuit Judge, dissenting.

This appeal is from the decision of the Court of Federal Claims, on remand from the Federal Circuit. This court had held that the fixed-price contract between AT&T and the Navy for development and production of the Surveillance Towed-Array Sensor System (a system for detecting previously undetectable submarines) was not void ab initio after complete performance, despite the Navy's admitted violation of Section 8118[1] of Pub. L. No.

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[1] **Section 8118** . . . . . None of the funds provided for the Department of Defense in this Act may be obligated or expended for fixed price-type contracts in excess of $10,000,000 for the development of a major

100-202. AT&T v. United States, 177 F.3d 1368 (Fed. Cir. 2001) *(en banc)*. The Federal Circuit held that violation of Section 8118 was not a ground for retroactive annulment of the contract, explaining that:

> When a contract or a provision thereof is in violation of law but has been fully performed, the courts have variously sustained the contract, reformed it to correct the illegal term, or allowed recovery under an implied contract theory; the courts have not, however, simply declared the contract void ab initio.

Id. at 1376 (citing cases). The court remanded to the Court of Federal Claims for consideration of the question of relief, on the premise that the contract was not void ab initio.

On remand the trial court did not consider the questions raised concerning the cost of performance of the contract. This highly advanced military system was successfully produced by AT&T, but at a cost several times the original estimate. AT&T said, and it was not disputed, that new technological problems cost millions of dollars to solve. Although no record was developed, my colleagues on this panel suggest that AT&T deliberately bid a cost that it knew was too low, and on this hypothesis my colleagues suggest that AT&T waived additional compensation. My colleagues stress that AT&T is a

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system or subsystem unless the Under Secretary of Defense for Acquisition determines, in writing, that program risk has been reduced to the extent that realistic pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties. Pub. L. No. 100-202 §8118, 101 Stat. 1329-84 (1987).

"sophisticated" contractor, apparently concluding that AT&T took the risk of a $50 million overrun and waived review of entitlement based on unforeseen technologic problems. None of these aspects was the subject of evidence or findings.

My colleagues further suggest that AT&T did not challenge the fixed-price form of contract, although it knew that the Navy was violating directives and regulations, in order to avoid governmental oversight during performance -- a strange theory, also not the subject of evidence or findings. The proposition that a sophisticated contractor recognized the possibility of a $50 million loss but chose to take that loss in order to avoid scrutiny of its performance hardly accords with sophistication, or indeed with reality. I also take note of the finding by my colleagues that the AT&T technical capability was "inferior," a pejorative verdict on an issue outside the record; indeed, one must wonder if the Navy would select a technologically inferior candidate to develop so critical a defense.

None of these speculative theories was developed in the record; indeed, there was no evidence on any aspect of the project and its cost. The record before us shows only that the contractor completely and successfully performed a contact for which the technologic complexities, and the ensuing cost of technologic solutions, were seriously underestimated. As a fundamental premise of governmental procurement, it is presumed that the Navy believed that this submarine surveillance system could be developed and produced at the contract price. Indeed, if the Navy entered a contract that it knew could not be performed at the contract price, then the procurement was fatally tainted.

On remand the Court of Federal Claims simply dismissed the case, holding that since Section 8118 was

not "enforceable" by AT&T, AT&T had no claim based on the admitted violation of Section 8118 by the government; the court declined to consider any other ground presented by AT&T, including "reformation, implied contract recovery, rescission and restitution," 48 Fed. Cl. at 161, and did not explain its conclusion that none of these grounds could apply. Instead, the Court of Federal Claims limited its consideration to the role of Section 8118, despite the Federal Circuit's remand to consider the issue of relief. This panel also does not reach the issue of the remand. Instead, the panel majority simply restates and reexplains this court's prior ruling that violation of Section 8118 does not render a fully performed contract void ab initio.

The briefs raise factual and legal questions, and equitable aspects, the weight and value of which have never been aired, and on which evidence has never been adduced. I do not know whether this contract warrants relief. But it is incorrect to hold that the facts are irrelevant and that there can be no relief unless Section 8118 is enforceable by AT&T.[2] AT&T has not yet had its day in court. From my colleagues' affirmance of the dismissal of this action, I respectfully dissent.

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[2] I do not, of course, suggest that government procurement contracts are readily subject to change after performance. The law and precedent of contract and procurement require some grave error or mutual mistake or changed circumstance, such as would render it unconscionable for the government to require performance of the original terms. Government contracts differ from private contracts in that the government can always terminate a contract for "convenience," based on changed circumstances; the contractor, however, faces sever penalties for default if performance is discontinued.

UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

01-5044

AMERICAN TELEPHONE AND TELEGRAPH COMPANY

and

LUCENT TECHNOLOGIES, INC.,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

ORDER

A petition for rehearing en banc having been filed by the APPELLANTS,* and a response thereto having been invited by the court and filed by the APPELLEE, and the matter having first been referred as a petition for rehearing to

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* The National Defense Industrial Association and Government Electronics and Information Technology Association filed an amici curiae brief.

the panel that heard the appeal, and thereafter the petition for rehearing en banc and response having been referred to the circuit judges who are in regular active service,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for rehearing be, and the same hereby is, DENIED and it is further

ORDERED that the petition for rehearing en banc be, and the same hereby is, DENIED.

The mandate of the court will issue on February 3, 2003.

Circuit Judge MICHEL did not participate in the vote.

FOR THE COURT,

/s/
Jan Horbaly
Clerk

Dated: January 27, 2003

cc: C. Stanley Dees
Bryant G. Snee

Clarence T. Kipps, Jr.

AT&T V US, 01-5044
(CFC – 93-CV-483)

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* Note: Pursuant to Fed. Cir. R. 47.6, this order *
* is not citable as precedent. It is a public record. *

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In the United States Court of Federal Claims

No. 93 - 483 C
Filed: November 6, 2000

AMERICAN TELEPHONE AND TELEGRAPH COMPANY

and

LUCENT TECHNOLOGIES, INC.,

Plaintiffs,

v.

THE UNITED STATES,

Defendant.

) Contracts: Language
)in appropriations
)statute, cautioning
)against the use of
) fixed-price type
)contracts to fund
)developmental efforts
)absent a determination
) that realistic pricing
)can occur, reflects a
) housekeeping
)provision - an internal
) review and reporting
)procedure intended for
)the government's
)benefit - that creates
)no enforceable rights
)in a contractor.
)Similarly, procure-
)ment regulations that
)provide guidance on
)the use of fixed-price
)contracts are instruc-
) tional rather than
)mandatory and, as
) such, grant no
)enforceable rights to
) contractors.

C. Stanley Dees, J. Keith Burt, Michael A. Hopkins, Suzette Derrevere, McKenna & Cuneo, L.L.P., Washington, D.C. Thomas R. Suher, Dean L. Grayson, Lucent Technologies, Inc., for plaintiffs.

Bryant G. Snee, with whom were Acting Assistant Attorney General David W. Ogden, Director David M. Cohen, Department of Justice, Washington, D.C., James H. Haag, and Kevin Travis, Office of the General Counsel, Space and Naval Warfare Systems Command, Department of the Navy, for defendant.

OPINION

WIESE, Judge.

INTRODUCTION

At an earlier stage in this lawsuit, this court issued an opinion holding that American Telephone & Telegraph Company's (AT&T) fixed-price incentive-type contract with the Navy was void ab initio and that, in its place, AT&T was entitled to be paid for its contract efforts on an quantum meruit basis pursuant to an implied-in-fact contract. American Tel. & Tel. Co. v. United States, 32 Fed. Cl. 672 (1995).[1]

The basis for this ruling was the Navy's failure to comply with a statute - Section 8118 of the Defense Appropriations Act of 1987, Pub. L. No. 100-202, 101 Stat. 1329-84 (1987) - that prohibited the Department of Defense from either obligating or expending appropriated funds on

[1] As originally filed, the complaint in this action named only AT&T as the plaintiff. Lucent Technologies, Inc., formerly a wholly-owned subsidiary of AT&T, became a co-plaintiff in November 1999.

fixed-price contracts involving the acquisition of major systems or sub-systems in excess of $10 million, absent a determination in writing that "program risk has been reduced to the extent that realistic pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties." Although the contract that the Navy awarded to AT&T in 1987 came within the scope of Section 8118 - a fixed-price incentive fee contract in the initial amount of $19.2 million involving research, development, and production of a ship-towed undersea radar system - the determination required by the statute was never made. Accordingly, this court concluded that AT&T's contract was contrary to law and therefore void.

The ruling was reversed on appeal. In an en banc decision entered pursuant to an interlocutory appeal, the Federal Circuit ruled that courts should refrain from invalidating government contracts, particularly where those contracts have been fully performed, unless that outcome is expressly required by the statute or regulation that the contract contravenes or is warranted on the basis of the offended law's legislative history. In this case, the court of appeals concluded that "[b]oth the DoD administration of § 8118, and the congressional response to this administration, make clear that Congress did not intend that this enactment would terminate fully performed contracts because of this flawed compliance." 177 F.3d 1368, 1375 (1999). Pursuant to this ruling, the case was remanded to this court for further proceedings.

BACKGROUND

In the contract at issue, AT&T agreed to research, develop and produce the sonar component of a ship-towed undersea surveillance system, formally called the Reduced Diameter Array Subsystem (the RDA Subsystem), for the

fixed-price of $19 million. In the performance of this work, however, AT&T incurred costs far in excess of the adjusted amount of its contract ceiling price. After unsuccessfully seeking the recovery of these additional costs at the administrative level, AT&T brought suit in this court.

In the complaint that it initially presented here, AT&T sought recovery under two counts. Count I asserted a right to contract reformation, i.e., conversion of the contract to a cost-reimbursement undertaking, based on the contention that Section 8118, as well as certain procurement regulations and directives, precluded award of the RDA contract as a fixed-price development contract. Count I also advanced the argument that the RDA contract was void for illegality and that AT&T was therefore entitled to recover under quantum meruit. Count II added the argument that reformation was appropriate because the RDA contract resulted from a mutual mistake.

Following the return of the case to this court, AT&T, now joined by Lucent Technologies, Inc., moved to amend the complaint to add new theories of recovery. In the amended complaint, plaintiffs essentially restate the original grounds for relief - illegality and mutual mistake (now Counts I and V respectively) - and add four additional counts. The additional counts allege that the government fraudulently induced the contract (Count II), that the government breached the contract (Count III), that there was a failure of consideration (Count IV), and that the government wrongfully took plaintiffs' property, without compensation, in violation of the Fifth Amendment to the United States Constitution (Count VI).

The government now moves for dismissal of all counts of the amended complaint. We are urged to dismiss Counts II through IV (fraud in the inducement, breach of contract, failure of consideration) and Court VI (taking), for

lack of subject matter jurisdiction, and Count II (fraud in the inducement) for failure to plead fraud with the particularity required under RCFC 9(b). In the alternative, defendant contends that all counts should be dismissed for failure to state a claim upon which relief can be granted. Plaintiffs oppose dismissal and ask that we set the matter for trial on the merits.

On the basis of the parties' briefs and the oral argument that was heard on October 25, 2000, the court now concludes that the amended complaint should be dismissed for failure to state a claim upon which relief can be granted.

DISCUSSION

We begin our discussion with the government's contention that the additional grounds for relief that plaintiffs introduced in the amended complaint represent claims not previously submitted to the contracting officer and therefore are claims that may not now be heard by this court. We do not accept this argument.

To be sure, the government is correct on its basic point: under the Contract Disputes Act, 41 U.S.C. §§ 601-613 (1994 & Supp. IV 1998), a contracting, officer's decision on a claim is a prerequisite to this court's later exercise of jurisdiction over the same claim. Paragon Energy Corp. v. United States, 645 F.2d 966, 971 (Ct. Cl. 1981). The problem with the government's argument, however, rests in its assertion that plaintiffs' additional grounds for relief are new claims, that is, claims not previously considered by the contracting officer and therefore not now assertable here. We do not agree with this contention. Modern procedural law defines a claim as "an aggregate of facts which in various combinations, all comprising a common core or nucleus of the facts, may support a number of substantive legal theories with

corresponding remedies." Restatement (Second) of Judgments § 24 cmt. c (1982). The same definition applies to claims arising under the Contract Disputes Act. See Placeway Constr. Corp. v. United States, 920 F.2d 903, 907 (Fed. Cir. 1990) (recognizing that claims are distinct "if the claims as presented to the [contracting officer] will necessitate a focus on a different or unrelated set of operative facts as to each claim"). The application of this standard dictates rejection of the government's argument.

Both the claims that AT&T initially submitted to the contracting officer and the additional grounds for relief raised in the amended complaint turn on the same operative facts: the allegation that the award to AT&T of a fixed-price contract without assessment of the developmental risks inherent in the contract project violated Section 8118 as well as particular procurement regulations and directives. Thus, from AT&T's point of view, the new counts simply add new theories of recovery rather than new factual bases for recovery.

The government argues that plaintiffs cannot establish, under any form of analysis, that the new counts arise out of the same set of facts as relied upon in the original claim. Therefore, says the government, we should endorse the idea that plaintiffs are, in fact, asserting new claims. Again, we do not accept this contention. The dimensions of a claim are gauged by the facts that are invoked in support of it, not by the sufficiency of those facts to support the relief being claimed.

Plaintiffs do not tie their theories of recovery to any contract negotiations or to any contract terms. Rather, as we have said, they stake their case entirely on the proposition that the Navy violated the law by awarding the RDA contract on a fixed-price basis without first considering the level of technical risk inherent in the work to be performed. It is this

omission which plaintiffs say the law treats as an actionable wrong under the various legal theories they have invoked. The remedy they seek is the recovery of their uncompensated performance costs (plus a reasonable profit thereon), through various alternative approaches: reformation of the RDA contract to a cost-reimbursable undertaking; cancellation of the RDA contract and substitution of an implied contract, or, recission of the RDA contract accompanied by restitution. Based on the foregoing; we conclude that plaintiffs are not asserting new claims.

We turn now to the merits. The core proposition upon which plaintiffs rest their case is the contention that a contract that violates the law, but that is not rendered void ab initio on account of that violation, will support a remedy in the contractor's favor, i.e., a contract price adjustment. Two cases cited in support of this contention are New England Tank Indus. v. United States, 861 F.2d 685 (Fed. Cir. 1988) and Beta Systems Inc. v. United States, 838 F.2d 1179 (Fed Cir. 1988). However, we do not draw from these authorities a rule as broad as the one plaintiffs now urge. To the contrary, the legal principle these cases adopt is that it is only those price terms that disregard the dictates of a mandatory regulation or statute that can support the remedy of reformation.

In New England Tank, for example, the government, in exercising a contract renewal option, had impermissibly disregarded a funding limitation in order to retain the benefits of the option contract's below market price. The question whether the contractor could be relieved of this onerous pricing commitment turned on whether the funding limitation that the government had ignored was "a mandatory or binding regulation." 861 F.2d at 694. "Legal rights" the court noted, "flow from mandatory, not directory, requirements." Id. (citing Nordstrom v. United States, 342 F.2d 55, 59 (Ct. Cl. 1965)). In other words, the contractor

could not invoke the violation of the funding restriction as a basis for relief unless the government itself was without authority to disregard it.

The same reasoning is seen in Beta Systems. The contract in that case contained an economic price adjustment clause whose statistical index failed to approximate the changes in the contractor's material costs. In addressing the contractor's request for reformation based on mutual mistake, the court noted that Beta did not intend to use an index that failed to give fair weighting to its material costs, and the government, in turn, was presumed (as a matter of law) not to intend the use of an index that violated procurement regulations. On this basis the court ruled: "If the contract is in violation of the [Defense Acquisition Regulations] . . . then reformation is appropriate." 838 F.2d at 1186. Again, the touchstone for reformation was the transgression of a mandatory regulation.

Neither of these cases offers plaintiffs any support. Indeed, the very narrowness of their holdings - that only those price terms that harbor a violation of law can support reformation - renders them inapplicable to our situation. We are not concerned in this case with a statute that proscribes the use of a fixed-price contract. Rather, Section 8118, and the government's failure to abide by it, was identified in the en banc decision simply as "governmental non-compliance with internal review and reporting procedures." 177 F.3d at 1376. Thus, the government's omission was simply a failure to abide by housekeeping rules. And from the disregard of such rules, no actionable claim can arise. Cessna Aircraft Co. v. Dalton, 126 F.3d 1442, 1451-52, 1454-55 (Fed. Cir. 1997) cert. denied, 525 U.S. 818 (1998) (recognizing that contractor has no enforceable interest in contract procedures and contract clauses intended primarily for government's benefit).

Plaintiffs insist, however, that the Federal Circuit found Section 8118 to have been enacted for the benefit of prospective contractors, thus vesting them, as members of that community, with a right to seek redress for any injury resulting from the statute's violation. Indeed, plaintiffs say that it was the Federal Circuit's "unwillingness" to find the RDA contract void ab initio that most clearly supports the availability of a remedy in this court.

We do not agree. The question the court of appeals was asked to resolve was whether the Navy's failure to comply with Section 8118 rendered the RDA contract void from the start, not whether AT&T retained a right to challenge the contract despite a ruling as to its enforceability. To answer the question presented, the court of appeals looked to legislative history because the statute itself was silent about the outcome in the event of non-compliance.

Following a review of the legislative history, the court concluded that it is "clear that Congress did not intend that this enactment [Section 8118] would terminate fully performed contracts because of this flawed compliance." 177 F.3d at 1375. The court came to this conclusion because it saw Section 8118 as an internal review and reporting procedure intended for the government's benefit. Particularly instructive to the court was the legislative history's admonition that "this section [8118] not be used as the basis for litigating the propriety of an otherwise valid contract." 177 F.3d at 1375 (citing S. Rep. No. 100-326, 100th Cong., 2d Sess. at 105 (May 4, 1998)). Regarding this expression of legislative purpose, the appellate court observed: "This explicit statement of intent weighs heavily against judicial invalidation of 'an otherwise valid contract,' for the clearly stated congressional purpose is contrary." 177 F.3d at 1375.

The same reasoning that led the court of appeals to reject the argument that the RDA contract was void from the start now leads us to say that the contract is enforceable as it stands. Faithfulness to the legislative purpose underlying Section 8118 demands this result: non-compliance with the statute is not an actionable wrong. To say it another way, plaintiffs cannot claim a protectable interest in the proper application of Section 8118 for Congress intended to give them none. "[I]f the primary intended beneficiary of a statute or regulation is the government, then a private party cannot complain about the government's failure to comply with the statute or regulation, even if that party derives some incidental benefit from compliance with it." Cessna Aircraft, 126 F.3d at 1451-52.

In addition to claiming that award of the RDA contract on a fixed-price basis was a violation of Section 8118, plaintiffs make a similar claim based on various procurement regulations and directives. Included in this list of referenced regulations are Federal Acquisition Regulations § 16.104 and § 35.006 (48 C.F.R. § 16.104 and § 35.006 (1987)), Defense Federal Acquisition Regulations § 216.101 and § 216.104 (48 C.F.R. § 216.101 and § 216.104 (1987)), and Department of Defense Directive 5000.1 (September 1, 1987).

We have examined these sources but can find in them no support for the position claimed: they announce no obligatory, rules of government procurement. They are, instead, instructional materials, directed to contracting officers and other procurement-responsible personnel, that offer guidance on the use and selection of contract types. Although these materials do caution against the use of fixed-price contracts where developmental effort is involved, see, e.g., 48 C.F.R. § 216.104 (1987) and 48 C.F.R. § 35.006(c) (1987), we cannot go the extra step of saying that the adoption of such a contract in that setting would be a

violation of law. Clearly, that is not the case. The regulations make clear that "selection of the appropriate contract type is, in the final analysis, the responsibility of the contracting officer." 48 C.F.R. § 216.104(1) (1987).

But even if one could read these regulations as placing some limits upon a contracting officer's exercise of discretion in the selection of contract type, the time to have raised such concerns was when the RDA contract was being negotiated, not years after its completion. In fact, the very regulations that plaintiffs rely on point out that contract type and contract price go hand-in-hand. "Negotiating the contract type and negotiating prices are closely related and should be considered together." 48 C.F.R. § 16.103(a) (1987). Surely, as a sophisticated government contractor knowledgeable in the regulations that guide the government in the formation of its contracts, AT&T must have been aware of this regulation and the opportunity it presented to influence the ultimate choice of contract type. However, so far as we can tell from this record, AT&T never questioned the contracting officer's decision to use a fixed-price incentive-fee contract for the RDA procurement.[2] Now it is

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[2] We would note in passing that, under the regulations, a fixed-price incentive-fee contract is suggested for use in those situations where the absence of precise specifications generates difficulties in estimating costs with accuracy. The regulation, 48 C.F.R. § 35.006(c) (1987), states as follows:

> (c) Because the absence of precise specifications and difficulties in estimating costs with accuracy (resulting in a lack of confidence in cost estimates) normally precludes using fixed-price contracting for R&D, the use of cost-reimbursement contracts is usually appropriate . . . . The nature of development work often requires a cost-reimbursement completion arrangement

too late to do so. Whittaker Electronic Sys. v. Dalton, 124 F.3d 1443, 1446 (Fed. Cir. 1997) (holding that contractor's failure to object in a timely fashion to the inclusion of an option clause "prior to execution, or even prior to litigation," resulted in waiver of a right to challenge such inclusion at a later date).

CONCLUSION

The several theories of recovery that plaintiffs have raised in this remand proceeding are founded on the premise (i) that the Navy was required by Section 8118, as well as by various procurement regulations and directives, to award the RDA contract on a cost-reimbursement basis, and (ii) that plaintiffs, as the intended, but thwarted, beneficiaries of these laws, may now seek their enforcement through a variety of legal remedies - reformation, implied contract recovery, recission and restitution - all directed towards a repricing of the work performed under the RDA contract.

Because we have concluded that plaintiffs have no enforceable interest in Section 8118 or in the procurement regulations and directives on which they also rely, we direct the dismissal of their amended complaint for failure to state a claim on which relief can be granted.

> . . . . When the use of cost and performance incentives is desirable and practicable, fixed-price incentive and cost-plus-incentive-fee contracts should be considered in that order of preference.

United States Court of Appeals for the Federal Circuit

95-5153, -5154

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,

and

LUCENT TECHNOLOGIES INC.,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant/Cross-Appellant.

DECIDED: May 26, 1999

Before MAYER, Chief Judge, NEWMAN, PLAGER, LOURIE, CLEVENGER, RADER, SCHALL, BRYSON, and GAJARSA, Circuit Judges.*

Opinion for the court filed by Circuit Judge NEWMAN, in which Circuit Judges CLEVENGER, SCHALL, BRYSON, and GAJARSA join. Opinion concurring in result filed by Circuit Judge RADER,

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* Circuit Judges Rich and Michel did not participate in this decision.

in which Chief Judge MAYER and Circuit Judge LOURIE join. Opinion dissenting-in-part and concurring-in-part filed by Circuit Judge PLAGER.

NEWMAN, Circuit Judge.

We took this appeal and cross-appeal *en banc* to reconsider the questions of law presented, upon certification for interlocutory appeal, concerning the applicability of §8118 of the Defense Appropriations Act of 1987 to a contract between the Department of the Navy and the American Telephone and Telegraph Company. The Court of Federal Claims ruled that in view of the failure of the Department of Defense to comply with §8118, the contract, which had been performed, was void *ab initio*. We now hold that the contract was not void, and remand to the Court of Federal Claims for further proceedings in accordance with this premise.

The Reduced Diameter Array Contract

This contract arose in Cold War response to the new ultra-quiet Soviet submarines, which were difficult to monitor using available technology and equipment. Effective antisubmarine response requires that hostile submarines be reliably detected, classified, located, and tracked. The Navy, among its programs for this purpose, employed an integrated undersea acoustic sonar system called the Surveillance Towed-Array Sensor System (SURTASS). In SURTASS a suitably equipped surface vessel tows an array of undersea detection equipment through the ocean, while the equipment collects and transmits appropriate data for processing on shipboard and for transmission to shore-based facilities. The President's Annual Report to the Congress for fiscal 1987, on the topic of Antisubmarine Warfare Forces, referred to SURTASS as "[o]ne of our most important ongoing programs in this area." Id. at 188.

On December 31, 1987, after competitive bidding, the Navy awarded AT&T a fixed price incentive fee contract for a subsystem of SURTASS, referred to as the Reduced Diameter Array. The contract was a "Total Package Procurement," requiring design of shipboard and shore--based electronics, ship-winch interface and tow cable, and an acoustic and electronic array some 8,000 feet long, to meet the new Soviet submarine capabilities. The contract required research, development, and the delivery and testing of an engineering development model, at a fixed ceiling price of $19,221,630, and included an option to the Navy to acquire a second engineering development model at a fixed ceiling price of $3,510,253, and an additional option to acquire three production-level models at a fixed ceiling price of $8,475,466.

The contract was successfully performed by AT&T over a period of five years. With the price adjustments to which the Navy agreed during performance, the final fixed price was approximately $34.5 million. AT&T states that technical problems and unknowns arose throughout performance, and that its total cost was at least $91 million. The Navy rejected AT&T's requests for restructuring the contract and other relief, although AT&T directed attention to §8118 of the Defense Appropriations Act and relevant Department of Defense policy directives concerning procurement of research and development for new technologies.

AT&T duly brought suit in the Court of Federal Claims under the Contract Disputes Act. On cross motions for summary judgment the issues arising from the enactment of §8118 were presented and argued. The Court of Federal Claims ruled that § 8118 applied to this contract, that it had not been complied with by the Department of Defense, and

that the contract consequently was void *ab initio*. Responding to AT&T's proposal that the appropriate remedy was to reform the contract into the cost-reimbursement form favored by §8118, the Court of Federal Claims held that since there had never been a valid contract it could not be reformed. The court held, however, that AT&T was entitled to compensation for its work on the basis of *quantum meruit*, on a theory of implied-in-fact contract. Before proceeding to determine quantum, the court certified for interlocutory appeal, in accordance with 28 U.S.C. §1292(d)(2), the following questions:

> (i) whether a contract executed in violation of statutory restrictions on the obligation and expenditure of appropriated funds may be declared void from the start at the instance of the performing contractor, and, if so,
>
> (ii) whether compensation for benefits conferred upon the Government (pursuant to the voided contract) can be predicated on an implied-in-fact contract with the amount of recovery to be determined pursuant to unjust enrichment principles.

A panel of the Federal Circuit, by split decision, affirmed the ruling that the contract was void *ab initio*. The court also held that no relief was available to AT&T on any theory, except perhaps to replevin the goods that had been delivered to the Navy. Upon the petitions of both sides we have reheard the matter *en banc*.[1]

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[1] The panel decision of the Federal Circuit, reported at American Tel. & Tel. Co. v. United States, 124 F.3d 1471 (Fed. Cir. 1997), was vacated and withdrawn, 136 F.3d 793 (Fed. Cir. 1998). The decision of the Court of Federal Claims is reported at 32 Fed. Cl. 672 (1995), and the certification for

Section 8118 of the Defense Appropriations Act of 1987

Concern about the use of fixed price contracts for research and development phases pervades defense procurement. In 1971 Department of Defense Directive (DODD) 5000.1 stated that "[i]t is not possible to determine the precise production cost of a new complex defense system before it is developed," and established the policy of using cost-reimbursement price terms for procurement of research and development. The Directive stated: "Fixed price contracts are normally not appropriate for research and development phases." DODD 5000.1 ¶D.9.g (as amended, Sept. 1, 1987). The Federal Acquisitions Regulations governing R&D contracts also embodied this policy. See, e.g., 48 C.F.R. §35.006(c) (1984-1998) ("Because the absence of precise specifications and difficulties in estimating costs with accuracy (resulting in a lack of confidence in cost estimates) normally precludes using fixed-price contracting for R&D, the use of cost-reimbursement contracts is usually appropriate.")

The record states that in the 1980s, despite these policy directives, the Navy returned to fixed price contracting for R&D as part of the Total Package Procurement concept. This in turn led to congressional investigations and hearings. An investigation conducted by the House Appropriations Committee concluded that for the development phases of new technologies, the Navy's use of fixed price contracting resulted in program delays, cost overruns, contractor claims, non-participation, and litigation. See Surveys & Investigations Staff, Report to the Comm. on Appropriations, U.S. House of Representatives: Navy Fixed

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interlocutory appeal is reported at 33 Fed. Cl. 540 (1995). On this rehearing *amicus* briefs were filed by the Federal Circuit Bar Association and by the Electronic Industries Alliance and Aerospace Industries Association of America.

Price Contracting in the Research, Development, Test and Evaluation (RDT&E) Account, 100th Cong., 1st Sess. (1987). The Report stated that: "Although Navy officials at the headquarters level have predicted immense success for the acquisition policy, the opinions expressed by Navy and other Service field procurement officials and technical experts indicated that [fixed price contracting] generally [has] proved unsuitable in an R&D environment:" Id. at ii. The Report concluded that the nature of the work in research and exploratory development contracting "most frequently necessitates" use of the cost-reimbursement type contract. Id. at 11.

At ensuing hearings on the 1988 Defense budget, concern was expressed about the continuing use of fixed price contracts for high-cost, high-risk development projects, as well as concern for meeting congressional oversight and allocation obligations under this form of procurement. Department of Defense Appropriations for 1988: Hearings Before the Defense Subcomm. of the Comm. on Appropriations, 100th Cong., 454-55 (1987). Legislatively implementing these concerns, the House included in the Defense Appropriations Act of 1987 the provision that became §8118:

> **§8118.** None of the funds provided for the Department of Defense in this Act may be obligated or expended for fixed price-type contracts in excess of $10,000,000 for the development of a major system or subsystem unless the Under Secretary of Defense for Acquisition determines, in writing, that program risk has been reduced to the extent that realistic pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties: *Provided,* That the Under Secretary may not delegate

> this authority to any persons who hold a position in the Office of the Secretary of Defense below the level of Assistant Under Secretary of Defense: *Provided further,* That the Under Secretary report to the Committees on Appropriations of the Senate and House of Representatives in writing, on a quarterly basis, the contracts which have obligated funds under such a fixed price-type developmental contract.

Pub. L. No. 100-202, § 8118, 101 Stat. 1329, 1329-84 (Dec. 22, 1987). The accompanying Conference Report reiterated congressional concern that the risks of failure and of cost uncertainties be allocated equitably between government and contractor, and stressed the desire to "maintain the government's credibility as a reliable business partner." H.R. Conf. Rep. No. 100-498 at 623 (Dec. 22, 1987). Congress referred to the burden of a fixed price contract on the contractor when the miscalculation of development cost may have been that of the government agency as well as the contractor, and to the reluctance of some highly qualified firms to enter into such contracts. The Conference Report was unambiguous: "Fixed price contracts are normally not appropriate for research and development phases." Id. at 624. Thus Congress acted to adjust the risks of developing the advanced technologies needed in the service of national defense.

Application of Section 8118

Section 8118 prohibited the award of certain fixed price-type contracts unless the program risk was evaluated at a high level within the Defense Department, and required quarterly reports of such awards to the House and Senate Appropriations Committees. The government argues first that §8118 did not apply to the Reduced Diameter Array contract, thus eliminating any need for the Navy to have

complied with the statute. The Court of Federal Claims correctly held otherwise.

Section 8118 by its terms applies to "fixed price-type contracts in excess of $10,000,000 for the development of a major system or subsystem." The government argues that the Reduced Diameter Array is not a "major system," referring to a memorandum issued six weeks after enactment of §8118 wherein the Under Secretary of Defense defined "major system" for the purposes of §8118 as a system having a contract cost of over $75,000,000. In a Memorandum for Service Acquisition Executives, Directors of the Defense Agencies issued February 11, 1988, Under Secretary of Defense for Acquisition Costello instructed that "[t]he definition of major system at 10 U.S.C. §2302(5) is the definition of that term for the purpose of [§8118]." This content was incorporated into SECNAV Instruction 4210.6A (April 13, 1988).

Section 2302(5) is a provision of chapter 137 of Subtitle A - General Military Law, which as then written defined "major system" as a system costing more than $75,000,000 for research, development, test, and evaluation:

> **10 U.S.C. §2302(5).** The term "major system" means a combination of elements that will function together to produce the capabilities required to fulfill a mission need. The elements may include hardware, equipment, software or any combination thereof, but excludes construction or other improvements to real property. A system shall be considered a major system if (A) the Department of Defense is responsible for the system and the total expenditures for research, development, test, and evaluation for the system are estimated to be more than $75,000,000 (based on fiscal year 1980 constant

> dollars) or the eventual total expenditure for procurement of more than $300,000,000 (based on fiscal year 1980 constant dollars). . . .

The government argues that the agency had discretion to define the §8118 "major system" in accordance with §2302(5), and thereby to place a $75,000,000 floor on the systems to which §8118 would apply. However, it was not within the agency's discretion to rewrite §8118 to replace the statutory threshold of $10,000,000 with that of $75,000,000. Although an agency's interpretation of a statute it administers is indeed entitled to deference, agency discretion does not extend to changing a clearly stated dollar figure. See Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984) ("if the intent of Congress is clear, that is the end of the matter").

In addition, the AT&T contract itself, and the Space and Naval Warfare Systems Command's guide to the SURTASS, described the Reduced Diameter Array as a "subsystem." Subsystems were not defined in §2305(5) and were not mentioned in the Memorandum of the Under Secretary. However, subsystems costing more than $10,000,000 were explicitly included in §8118. Although the government now argues that the Under Secretary's Memorandum and SECNAV Instr. 4210.6A really covered a major system or a subsystem of a major system, this interpretation is contrary to the plain text of these documents. It is apparent that the Memorandum was contrary to the statute, and in all events that it did not include subsystems such as the Reduced Diameter Array.

The government also argues that not all of the funds expended under the Reduced Diameter Array contract were appropriated in the corresponding Appropriations Act, and thus that the §8118 prohibition on obligating or expending

funds does not apply. Indeed, the contract was structured for multi-year incremental funding. However, it is undisputed that the starting research and development effort drew on several millions of dollars of appropriated funds. The multi-year funding does not excuse the Defense Department from compliance with §8118.

Moreover, contrary to the government's argument, which is made but not strongly pressed, this case does not involve a funding deficiency or implicate the Anti-Deficiency Act, 31 U.S.C. §1341. See Hercules Inc. v. United States, 516 U.S. 417, 427 (1996) ("The Anti-Deficiency Act bars a federal employee or agency from entering into a contract for future payment of money in advance of, or in excess of, an existing appropriation."); see generally Ferris v. United States, 27 Ct. Cl. 542, 546 (1892) ("An appropriation per se merely imposes limitations upon the Government's own agents . . . its insufficiency does not pay the Government's debts, nor cancel its obligations, nor defeat the rights of other parties.") There is no issue in this case of lack of appropriated funds.

We affirm the determination of the Court of Federal Claims that §8118 applies to this contract. The government does not dispute that the requirements of §8118 were not met by the Department of Defense. There is no assertion that the Under Secretary of Defense for Acquisitions made or had made the program risk and pricing determinations required by §8118, and no report of this contract is stated to have been made to the Senate and House Appropriations Committees. Although the government stresses that the contract was awarded only nine days after the enactment of §8118, this does not excuse the failure of all compliance.

Consequences of Agency Noncompliance With §8118

We turn to the certified question of the consequences of this failure of compliance by the Department of Defense. AT&T states that §8118 was enacted at least in part for its protection, and that the agency, by failing to obey the law, can not deprive AT&T of the protection of the law. AT&T argues that §8118 is a "mandatory statute" restricting the agency's authority to obligate and expend funds, and that the Navy's direct contravention of §8118 rendered the Reduced Diameter Array contract void *ab initio*.

The government responds that Congress chose and intended to enforce §8118 through its oversight powers, and that AT&T can not benefit from whatever lapses may have occurred within the Department of Defense in its compliance with congressional oversight legislation. The government stresses that §8118 did not provide that these fixed price contracts were prohibited, but only that the Defense Department must review the risk and its allocation at a specified executive level, and must report to Congress on a quarterly basis.

Legislative intent and precedent both lead to the conclusion that the AT&T contract was not void *ab initio* as a consequence of the agency's noncompliance. Invalidation of the contract is not a necessary consequence when a statute or regulation has been contravened, but must be considered in light of the statutory or regulatory purpose, with recognition of the strong policy of supporting the integrity of contracts made by and with the United States. In United States v. Mississippi Valley Generating Co., 364 U.S. 520 (1961) the Court explained that when a statute "does not specifically provide for the invalidation of contracts which are made in violation of [its provisions]" the court shall inquire "whether the sanction of nonenforcement is consistent with and essential to effectuating the public policy

embodied in [the statute]." Id. at 563. Thus the policy underlying the enactment must be considered in determining the remedy for its violation, when the statute itself does not announce the sanction of contract invalidity.

The policy embodied in §8118 is elucidated in the congressional response when §8118 did not receive full compliance from the Department of Defense. See Alabama Rural Fire Ins. Co. v. United States, 572 F.2d 727, 733 (Ct. Cl. 1978) ("illegality may be proved with reference to legislative history"). Congress simply tightened the reporting provision, by moving from after-the-fact quarterly reports to before-award reports. Indeed, the House version of §8118 had initially required before-award reports, but this was dropped in Conference in favor of the Senate version "to reduce the appearance of congressional micromanagement." H.R. Conf. Rep. No. 100-498 at 623 (Dec. 22, 1987).

The Conference Report stated that if Defense Department policy did not become more uniform, "more severe restrictions" would be imposed. Id. This remark carries no hint of, and indeed belies, an interpretation that §8118 was intended, upon enactment, to invalidate any contract made without meeting its internal review and reporting requirements, for such a "restriction" would already be extremely "severe." The statutory shift to before-award reports in succeeding years would be a trivial discipline indeed, if meanwhile all of the fixed price contracts within the statutory scope, although in the process of performance, or as in this case fully performed, were void *ab initio*.

Only a few months after enactment of §8118 the House Appropriations Committee reported that the "enforcement of existing policy in this area has not yet been demonstrated," H.R. Rep. No. 100-681 at 147 (June 10,

1988), and recommended a pre-award reporting requirement (which was included in the enactment for the next fiscal year). The Senate Armed Services Committee, considering this renewal, stated explicitly that noncompliance was not intended to be "the basis for litigating the propriety of an otherwise valid contract":

> The committee recognizes that there are circumstances in which fixed-price development contracts are appropriate (e.g., when costs and foreseeable program risks can be reasonably anticipated), and the committee - expects the Department to establish clear guidelines under this section for use of such contracts.
>
> It is the intent of the committee that this section be applied in a manner that best serves the government's interests in the long term health of the defense industry, and that this section not be used as the basis for litigating the propriety of an otherwise valid contract. Nothing in this section shall be construed to affect the requirements of section 8118 of the Department of Defense Appropriations Act, 1988.

(Emphasis added.) S. Rep. No. 100-326, 100th Cong., 2d Sess. at 105 (May 4, 1988). This explicit statement of intent weighs heavily against judicial invalidation of "an otherwise valid contract," for the clearly stated congressional purpose is contrary.

These congressional responses, made with knowledge of the agency's imperfect compliance with §8118, negate any reasonable inference that Congress intended simply to render void *ab initio*, even after full performance, any fixed price contract for which the Under Secretary's review of risk allocation and the report to the Committees

were omitted. Congress can not have intended to charge the contracting partner with adverse consequences depending on whether the Defense Department carried out the internal responsibilities and filed the reports that Congress required.

Nor is it the judicial role to discipline the agency's noncompliance with the supervisory and reporting instructions of congressional oversight. See Longshore v. United States, 77 F.3d 440, 443 (Fed. Cir. 1996) ("Congress has undoubted capacity to oversee the performance of Executive Branch agencies, consistent with its constitutional authority. It is not for this court to instruct Congress on how to oversee and manage its creations."); E. Walters & Co. v. United States, 576 F.2d 362, 367 (Ct. Cl. 1978) ("The fact that a procurement practice is prohibited does not necessarily mean that it is therefore actionable. The discipline to be administered in such cases is a responsibility of the cognizant procurement officials within the agency [and not] by this court"); cf. National Treasury Employees Union v. Campbell, 654 F.2d 784, 794 (D.C. Cir. 1981) (by statutory requirement that the Comptroller General report on certain expenditures "Congress itself is in a position to monitor and enforce its spending limitations. It is not for us to question the effectiveness of existing remedies and infer additional remedies.")

Both the DoD administration of §8118, and the congressional response to this administration, make clear that Congress did not intend that this enactment would terminate fully performed contracts because of this flawed compliance.

Precedent reinforces our conclusion that the Reduced Diameter Array contract is not void *ab initio*. The invalidation of a contract after it has been fully performed is not favored. Precedent shows that those contracts that have

been nullified, based on a failure to meet a statutory or regulatory requirement, are contracts that have not been substantially performed. E.g., Alabama Rural Fire Ins. Co. v. United States, 572 F.2d 727, 733-34 (Ct. Cl. 1978). In Prestex, Inc. v. United States, 320 F.2d 367, 374-75 (Ct. Cl. 1963), the court held a contract invalid, and refused to allow any recovery because no performance had occurred. It is not surprising that much of the litigation raising issues of violation of statute or regulation at the inception of government contracts has arisen in the bid protest context, where the asserted illegality has been explored before substantial performance has occurred. E.g., CACI, Inc. v. Stone, 990 F.2d 1233, 1235 (Fed. Cir. 1993); Schoenbrod v. United States, 410 F.2d 400, 403-04 (Ct. Cl. 1969). We take incidental note that the case at bar also involved a disappointed bidder raising post-award objections, and that none of the objections were based on §8118.

In Harbor Gateway Commercial Property Owners' Ass'n v. United States Environmental Protection Agency, 167 F.3d 602 (D.C. Cir. 1999), a case stressed in the dissenting opinion hereto, the court voided an EPA action because the Governor had not signed the request as the statute required. However, there was no issue of performance, or reliance, or any other contractual element. It is not before us to decide whether either party to the Reduced Diameter Array contract could have voided the contract early in its life and without penalty; the contract was performed for over five years, with no record suggestion from either party that because of §8118 there was no contract.

Judicial reluctance to annul performed contracts when the government did not comply with a statutory or regulatory requirement was explained by the Court of Claims in John Reiner & Co. v. United States, 325 F.2d 438, 440 (Ct. Cl. 1963), stating that "the court should ordinarily

impose the binding stamp of nullity only when the illegality is plain." In Reiner the court recognized the "dilemma" of a contractor who becomes aware, while deep in the performance of a contract, of a possible procurement illegality he did not cause: the contractor must either continue to perform a contract of uncertain validity, or discontinue performance and risk severe penalties if a court later disagrees with his assessment of the illegality.

When a contract or a provision thereof is in violation of law but has been fully performed, the courts have variously sustained the contract, reformed it to correct the illegal term, or allowed recovery under an implied contract theory; the courts have not, however, simply declared the contract void *ab initio*. For example, in LaBarge Products v. West, 46 F.3d 1547, 1552-53 (Fed. Cir. 1995) there was an illegal disclosure by the government during bidding; this court noted that the contract had been substantially performed and held that a valid contract existed despite the violation. In Beta Systems, Inc. v. United States, 838 F.2d 1179, 1185-86 (Fed. Cir. 1988) the court allowed reformation of the contract price term to correct a regulatory violation, stating that "[t]he risk of unintentional failure of a contract term to comply with a legal requirement does not fall solely on the contractor." In Urban Data Systems, Inc. v. United States, 699 F.2d 1147, 1154 (Fed. Cir. 1983) the court held that a contract price term that was contrary to law did not invalidate the fully performed contract. In Trilon Educational Corp. v. United States, 578 F.2d 1356, 1360 (Ct. Cl. 1978) the court sustained a contract that was awarded after the contracting officer had negligently failed to meet a regulatory responsibility; the court held that the non-compliance with regulation was "a matter for internal resolution" and "did not render the resultant contract a nullity." In Clark v. United States, 95 U.S. 539, 542 (1877) the Court held a parol contract void for violation of the

statute of frauds, but allowed recovery on an implied contract theory.

The entirety of precedent strongly supports our conclusion that the Reduced Diameter Array contract is not void *ab initio.* Precedent does not favor the invalidation, based on governmental noncompliance with internal review and reporting procedures, of a contract that has been fully performed by either contracting party.[2]

Although the parties discuss possible remedies, the issue of what relief may be available to AT&T is not before us, for the Court of Federal Claims did not consider AT&T's claims on the premise that the underlying contract was not void. We have not considered this issue, and express no view thereon.

Answers to the Certified Questions

For the reasons we have discussed, we conclude that the agency's failure to comply with the obligations of §8118 did not render the Reduced Diameter Array contract void *ab initio.* Any failure by the Department of Defense in its internal compliance with §8118 can not be invoked, particularly after full contract performance, either to strip the

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[2] The dissenting opinion would hold the fully performed AT&T/Navy contract void *ab initio,* stating that the purpose of §8118 was to "prevent contracts with the United States in contravention of its terms". However, Congress' stated concern was to curb the Navy's use of fixed price R&D contracting so as to "maintain the government's credibility as a reliable business partner," H.R. Conf. Rep. No. 100-498 at 623 (Dec. 22, 1987), not to bar essential defense procurement. The dissent's proposed nullification of this fully performed contract would do little for "the government's credibility as a reliable business partner."

Navy of authority to have entered into the contract or to bar AT&T from presenting such claims, if any, that it may have.

The second certified question relates to remedy, but is based on the premise that the contract was void *ab initio*. Since that premise is incorrect, we do not reach the second certified question.

Costs

Each party shall bear its costs.

QUESTIONS ANSWERED: CASE REMANDED

United States Court of Appeals for the Federal Circuit

95-5153, -5154

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,

and

LUCENT TECHNOLOGIES INC.,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Cross Appellant.

RADER, Circuit Judge, concurring in the result, in which MAYER, Chief Judge, and LOURIE, Circuit Judge, join.

Because § 8118 of the Defense Appropriations Act does not apply to this contract, I concur. Section 8118 provides in relevant part:

> None of the funds provided for the Department of Defense in this Act may be obligated or expended for fixed-price-type contracts in excess of $10,000,000 for the development of a major system or subsystem . . . .

(emphasis added). This particular section of the U.S. Code does not supply a definition of "major system." However, §

2302(5) of title 10 of the United States Code, which relates to government procurement contracts generally, defines "major system:"

> The term "major system" means a combination of elements that will function together to produce the capabilities required to fulfill a mission need . . . . A system shall be considered a major system if (A) the Department of Defense is responsible for the system and the total expenditures for research, development, test and evaluation for the system are estimated to be more than $75,000,000 . . . or (C) the system is designated a "major system" by the head of the agency responsible for the system.

Therefore, the term "major system" refers to systems either with estimated costs above $75,000,000 or systems "designated a 'major system' by the head of the agency responsible for the system." See 10 U.S.C. § 2302(5) (1986). Shortly after enactment of § 8118, both the Department of Defense and the Navy incorporated this statutory definition into their interpretation of that section. As the agency charged with interpretation and application of the statute, the Department of Defense's reasonable interpretation of § 8118 deserves deference. See Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 844 (1984).

The Department of Defense and Navy's interpretation alone gives meaning to all of the words in the statute. Both the Court of Federal Claims' interpretation and this court's interpretation in this opinion would render the "major system or subsystem" language superfluous and would invoke § 8118 for any fixed-price contract in excess of $10,000,000. This court chooses that course on the reasoning that the

agency's interpretation "rewrite[s] § 8118 to replace the statutory threshold of $10,000,000 with that of $75,000,000." This reasoning, however, discounts the statute's alternative method of categorizing a project as a "major system," namely, designation by the head of the agency. Thus, a project beneath the $75,000,000 threshold of 10 U.S.C. § 2302(5) could nonetheless qualify as a "major system" upon designation by the head of the agency.

This court's opinion discounts the reasonable reconciliations of the $10,000,000 contract amount requirement with the "major system" classification requirement. Under the agency's reasonable interpretation, the $10,000,000 contract amount requirement serves as a floor for invoking § 8118 in contracts involving a project designated as a "major system" by the department head. Furthermore, the $10,000,000 contract amount requirement does not lose its meaning for systems whose estimated costs exceed $75,000,000. Development of a major system typically requires multiple contracts with multiple developers. In these cases, the $10,000,000 requirement serves as a floor for application of § 8118 to each contract involved in the development of that "major system." Similarly, the $10,000,000 trigger amount excludes from § 8118 any subsystem contracts within a major system which do not satisfy this threshold amount. For these reasons, the $10,000,000 threshold continues to govern in conjunction with the $75,000,000 threshold for a "major system." In sum, these dual thresholds work together and provide a reasonable explanation for the agency's interpretation of these statutes. Because reasonable, the agency's interpretation deserves deference.

Even without deference to the Departments of Defense and Navy, their proposed interpretation of § 8118 alone gives meaning to all the statute's terms and should

therefore govern this court's resolution. As noted above, this is the only interpretation which supplies meaning to all of the terms of the statute. Specifically, this is the only interpretation which gives meaning to the term "major system" as well as the $10,000,000 contract amount requirement.

Finally, I read the term "subsystem" in § 8118 as linked to "major system" by its context within the statute. Although neither 10 U.S.C. § 2302(5), nor the interpretations of § 8118 proffered by the Department of the Defense or the Navy address the definition of "subsystem," the statute itself ties the definition of this term to the term "major system." In essence, this interpretation would apply § 8118 to "major systems and subsystems of major systems." This reading preserves the statute's "major system or subsystem" requirement rather than expanding application of § 8118 to all fixed-price-type contracts exceeding $10,000,000.

Furthermore, to my eyes, this appeal does not present the question of whether this Reduced Diameter Array is a "subsystem" of a "major system." Although AT&T asserted below that the Reduced Diameter Array subsystem was a part of SURTASS, and that SURTASS was a major system according to the requirements of 10 U.S.C. § 2302(5), by consent of the parties before the Court of Federal Claims, that issue is not a subject of the certified appeal. For these reasons, I would not apply § 8118 to the Reduced Diameter Array contract at issue in this appeal.

United States Court of Appeals for the Federal Circuit

95-5153, -5154

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,

and

LUCENT TECHNOLOGIES INC.,

Plaintiffs-Appellants,

v.

THE UNITED STATES,

Defendant/Cross-Appellant.

PLAGER, Circuit Judge, dissenting-in-part and concurring-in-part.

I must respectfully dissent. The court refuses to honor an explicit mandate of an unequivocal Congressional enactment. "Legislative history" cannot justify that refusal.[1] A court has a responsibility to arrive at the right result in a case; it also has the obligation to explain itself in a manner that does no harm to the fabric of the law. Though the right result may eventually emerge, the route the court takes to get

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[1] A similar, reaction was eloquently expressed by Chief Judge Joseph of the Oregon Court of Appeals in an award to his colleagues. See Western Communications, Inc. v. Deschutes County, 788 P.2d 1013, 1017 (Or. App. 1990) (Joseph, C.J., dissenting-in-part, concurring-in-part).

there has the potential for causing considerable harm to legal principles that I deem important.

In the first part of its opinion, the court describes the Government's efforts over time to adjust the risks that are inherent in cutting-edge R&D contracts so that they are fair both to the Government and the contractor. See slip op. at 2-4. These efforts begin at least in 1971 with DODD 5000.1, and culminate, for purposes of this case, with the enactment in 1987 of § 8118 as part of that year's Department of Defense ("DoD") Appropriations Act. See id. at 4-7. As the court explains, § 8118 prohibited using Government funds for fixed price-type R&D contracts except under certain conditions.

The court then sets out the history of the R&D contract at issue in this case, and concludes, correctly, that Section 8118 applies to this DoD fixed price-type alleged contract. See id. at 7-10. The court concludes, again correctly, that the exception provided in the statute, permitting a fixed price-type R&D contract under certain conditions, is not applicable since the DoD did not take the steps necessary to qualify for an exception. See id.

This is the same conclusion on the point reached by the Court of Federal Claims, which this court now affirms. The court rejects the Government's various arguments to the contrary, and finally concludes this part of its analysis with the statement that: "Although the government stresses that the contract was awarded only nine days after the enactment of § 8118, this does not excuse the failure of all compliance." Id.

Given that the court recognizes the language of the Act to expressly prohibit the use of Government funds for such a contract, the obvious and ineluctable conclusion

would appear to be that there was no contract, since as a matter of law such contracts were prohibited, and since there could be no consideration offered for the contractor's promised performance. Remarkably, the court reaches exactly the opposite conclusion, and finds the contract valid, and presumably enforceable. For the reasons I shall explain, I cannot join the court in this.

1.

Omitting the inapplicable exception language and its related provisos, the operative words of the statute are clear and to the point: "**None of the funds provided for the [DoD] in this [Appropriations] Act may be obligated or expended for fixed price-type contracts** . . . ." It is a rule of constitutional law that, in absence of an express appropriation, agencies may not spend, and a *fortiori* cannot validly contract to spend, any federal dollars. See U.S. Const. art. I, § 9, cl. 7 ("No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law."). The Supreme Court earlier reversed us when in another context we failed to properly apply that principle. See Office of Personnel Management v. Richmond, 496 U.S. 414 (1990).

Here, we do not have simply an omission of authorization to expend; we have an outright prohibition: "**None** of the funds [otherwise appropriated] may be expended . . ." for the precise purpose for which the DoD contracted. Surely it should not be necessary for Congress to have added: "and we mean it," or perhaps, "and we mean it, and if you try, it won't be any good, so don't even bother."

It is not uncommon for Congress to put prohibitions such as that contained in § 8118 in Acts appropriating funds

to executive branch agencies.[2] A recent case in point: Congress, in an Appropriations Act which included the U.S. Environmental Protection Agency,[3] specified that "none of the funds made available under this heading may be used by the Environmental Protection Agency . . . [for certain described activities affecting states] unless the Administrator receives a written request . . . from the Governor of the State . . . ." The EPA, on the basis of an authorizing letter from a state official, not the Governor, undertook such activity with regard to certain property in California. Affected interests appealed.

Judge Sentelle, writing for the Court of Appeals for the District of Columbia Circuit, found that the state official's letter did not meet the terms of the statute, and readily concluded that, in the absence of a letter from the Governor himself, the EPA action was "null and void," and "was necessarily invalid." Harbor Gateway Commercial Property Owners' Ass'n v. United States Envtl. Protection Agency, 167 F.3d 602, 607 (D.C. Cir. 1999).[4]

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[2] Cf. Rust v. Sullivan, 500 U.S. 173 (1991) (construing the phrase "method of family planning" in an Act appropriating funds to the Department of Health and Human Services, subject to a proviso that stated: "None of the funds appropriated under this subchapter shall be used in programs where abortion is a method of family planning.").

[3] See Omnibus Consolidated Rescissions and Appropriations Act of 1996, Pub. L. No. 104-134, 110 Stat. 1321-298.

[4] Judge Wald dissented. She did not disagree with the court's understanding of the consequences of noncompliance with the statute, but dissented on the grounds that the state official's letter was "the functional equivalent" of a

In response to the Government's argument that EPA officials considered themselves to be in compliance, and in any event an invalidation of the action would require that the action be done again and would just cost the Government more money, the District of Columbia Circuit answered:

> We refuse to ignore the plain language of the Act in order to avoid potential costs which would not have arisen had EPA complied with the statute's language in the first instance. Indeed, *when a statute's meaning is clear, and the enactment is within the constitutional authority of Congress, the "sole function of the courts is to enforce it according to its terms. "*

Id. at 606 (emphasis added). That seems to be the law on the subject; I know of no cases to the contrary, and the court here cites none.

In this case, AT&T, after due negotiation with the Navy, offered to make and sell to the Navy for an agreed fixed price a submarine-detecting piece of equipment. The Navy accepted the offer, and proposed to pay for the work using funds from the 1987 Appropriations Act that contained the express prohibition set out above. As the Harbor Gateway court explained, the Navy's action was "null and void," and "necessarily invalid."

Furthermore, the Navy's action in this case was taken for the purpose of entering into a contract. But the Navy was

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governor's letter. See Harbor Gateway, 167 F.3d at 607 (Wild, J., dissenting).

legally incapable of using Government funds unless it told Congress what it was up to in the manner required by the statute, which the Navy chose not to do. (It is difficult not to believe that both parties were fully aware of the statute and simply chose to ignore it, though that is of no moment to the issue before us.[5]) Thus, not only was the act of contracting prohibited by statute, but as a matter of basic contract law no legally-binding contract could be created: offer, acceptance, and consideration remain a fundamental requirement for a legally-binding contract, whether between private parties or between a private party and the Government. See, e.g., Harbert/Lummus Agrifuels Projects v. United States, 142 F.3d 1429, 1434 (Fed. Cir. 1998); Trauma Serv. Group v. United States, 104 F.3d 1321, 1325 (Fed. Cir. 1997). Here, the Government could neither offer or pay consideration; no consideration, no contract, end of discussion, at least with respect to contract validity under basic contract principles.

2.

I cannot agree with the court that the "purpose" of the statute overrides its express terms. The court tells us that this statute "must be considered in light of the statutory or regulatory purpose, with recognition of the strong policy of supporting the integrity of contracts made by and with the United States." Slip op. at 11. Clearly, however, the purpose of this statute, expressed in no uncertain language, is exactly the opposite - it is intended to *prevent* contracts with the United States in contravention of its terms, not to support them.

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[5] As my colleagues know, I spent some years of my life as a sea-going officer in the U.S. Navy; it is not easy for me to be critical of the Service, but the facts are what they are.

It has been some years since a court-invented "purpose" so blatantly repealed a Congressional enactment. Last century, in Rector, etc. of Holy Trinity Church v. United States, 143 U.S. 457, 471 (1892), the Supreme Court announced that this is a "Christian nation," and on that basis concluded that the purpose of a statute that banned immigration of foreign workers could not possibly be to prevent an English clergyman from coming to work in the United States. In this century, and certainly in recent times, purpose-inventing by judges has received the opprobrium it deserves when used as an excuse for ignoring the law.

Professor Dickerson, one of the early writers on statutory interpretation, described the process of purpose-inventing as if he had this case in mind:

> As with legislative intent, the danger in presuming an actual legislative purpose beyond what is expressly or impliedly revealed is that the interpreter will either attribute to the statute a purpose of his own contriving or search for actual purpose so relentlessly that he goes beyond the limits of the appropriate available evidence.

Reed Dickerson, The Interpretation and Application of Statutes 92 (1975).

Writing more formally for the Court a half-century ago, Justice Jackson said, "we take the Act as Congress gave it to us, without attempting to conform it to any notions of what Congress would have done if the circumstances of this case had been put before it." Western Union Tel. Co. v. Lenroot, 323 U.S. 490, 501 (1945). In the same vein, and more recently, the Supreme Court, Justice Scalia writing, said, "Courts may not create their own limitations on

legislation, no matter how alluring the policy arguments for doing so, ..." Brogan v. United States, 522 U.S. 398, 118 S. Ct. 805, 811-12 (1998).

In support of its position, the court cites various pieces of what it describes as legislative history. However, a prerequisite to judicial use of legislative history, even relevant legislative history, is a finding that the statute at issue is ambiguous. "Our first step in interpreting a statute is to determine whether the language at issue has a plain and unambiguous meaning with regard to the particular dispute in the case. Our inquiry must cease if the statutory language is unambiguous and 'the statutory scheme is coherent and consistent.'" Robinson v. Shell Oil Co., 519 U.S. 337 (1997) (Justice Thomas, writing for a unanimous Court) (quoting United States v. Ron Pair Enters., Inc., 489 U.S. 235, 240 (1989)). To the court's credit here, the majority does not pretend to find in this unequivocal statute any ambiguity. Rather, it simply concludes that committee report language, nowhere addressed to the specific problem before us, trumps statutory clarity.[6]

The committee report language the court cites includes certain 1988 House and Senate reports. In the first place, this so-called legislative history is not history - that is, the House and Senate Reports the court cites with such authority (see slip op. at 12-13) were written *after* § 8118 was enacted in 1987, and relate to later-considered legislation. How the views of a later Congress, not contained

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[6] The concurring opinion stays within established statutory interpretation principles by attempting to redefine the scope of § 8118. Unfortunately, for the reasons well-explicated in the opinion of the court majority, the attempt to have this contract escape the clutches of § 8118 fails.

in actual legislation, can be seen as amending or modifying prior legislative acts, is not explained. And, even assuming that any of that legislative history is relevant to understanding the 1987 Act, the only consistent thread in all of it is the expression of congressional irritation and frustration with the DoD's (or at least the Navy's) stubborn insistence on doing what Congress wanted stopped.

Further, when examined, even the terms in which the language of the 1988 Senate Report was written, heavily relied upon by the court to support its conclusion, see slip op. at 13, fail to support the court's view. The Report states that "this section [not § 8118 of the 1987 Act, but a later-proposed section] not be used as the basis for litigating the propriety of an otherwise valid contract." S. Rep. No. 100-326, at 105 (1988). Since by its terms a contract in direct violation of § 8118 is not "otherwise valid," the statement proves nothing with regard to § 8118, whether it be the 1987 version or the proposed 1988 version. And in case a court should miss that point, the very next sentence in the Report is: "Nothing in this section shall be construed to affect the requirements of section 8118 of the Department of Defense Appropriations Act, 1988." Id.

3.

The court finds further justification for its emasculation of the statute by opining that "Congress can not have intended to charge the contracting partner with adverse consequences depending on whether the Defense Department carried out the internal responsibilities and filed the reports that Congress required." Slip op. at 13. The response to that observation is that that would appear to be exactly what Congress intended. AT&T, one of the country's

leading government contractors,[7] could be expected to be familiar with government contracting laws. It is difficult to imagine that AT&T was unaware of the battle between Congress and the DoD over these fixed price-type contracts. At the least, it is not irrational for Congress to have assumed that a contractor, like AT&T, proposing to undertake a major R&D contract would know who in the DoD to contact regarding the requirements for the contract they were negotiating, and that the DOD's lawyers would know the relevant law.

What the court seems to have in mind here, though it does not say so, is the rule, sometimes called the "Golden Rule," that a statute should not be understood to call for an absurd result. Just as finding a statute ambiguous permits a court to go beyond the terms of the statute in searching for meaning, the Golden Rule permits a court to go beyond the apparent meaning of a statute when its application would be absurd.

Justice Kennedy described the Rule thusly:

> Where the plain language of the statute would lead to "patently absurd consequences," that

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[7] For the year 1987, AT&T was listed as 15th among the Top 100 Federal Contractors, with 1,438 procurement actions worth something over $2 billion. See Federal Procurement Data Center, Governmentwide Information Systems Division, MVS, GSA, Central Office, Top 100 Federal Contractors 14 (Jan. 25, 1988). AT&T was 16th in 1988. See Federal Procurement Data Center, Governmentwide Information Systems Division, MVS, GSA, Central Office, Too 100 Federal Contractors 14 (Feb. 2, 1989).

> "Congress could not *possibly* have intended,," we need not apply the language in such a fashion. . . . This exception remains a legitimate tool of the Judiciary, however, only as long as the Court acts with self-discipline by limiting the exception to situations where the result of applying the plain language would be, in a genuine sense, absurd, i.e., where it is quite impossible that Congress could have intended the result, and where the alleged absurdity is so clear as to be obvious to most anyone.

Public Citizen v. United States Dep't of Justice, 491 U.S. 440, 470 (1989) (Kennedy, J., concurring). One must wonder whether a statute that orders the DoD not to spend money in a wasteful way is "absurd" within the definition set forth by Justice Kennedy.

Emphasizing the narrow scope of the absurdity exception, Justice Kennedy went on to note:

> Where it is clear that the unambiguous language of a statute embraces certain conduct, and it would not be patently absurd to apply the statute to such conduct, it does not foster a democratic exegesis for this Court to rummage through unauthoritative materials to consult the spirit of the legislation in order to discover an alternative interpretation of the statute with which the Court is more comfortable. . . . The problem with spirits is that they tend to reflect less the views of the world whence they come than the views of those who seek their advice.

Id. at 473 (internal citations omitted) (Kennedy, J., concurring).[8]

4.

AT&T has no rightful claim to another penny of public money. It agreed to build and sell a product to the Government for a fixed price. It performed its end of the deal, and delivered the goods. The Government likewise performed its part of the deal; it paid AT&T the agreed-upon price (actually more, as a result of negotiated add-ons).

If the contract had been *valid* under governing law, AT&T would have no basis for claiming more money; our precedents are unequivocal that full payment under a valid fixed price-type contract is all to which a contracting party is entitled.[9] The risk of loss for misjudging what it takes to

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[8] Justice Rehnquist expressed the same sentiment in United Steelworkers of America v. Weber, 443 U.S. 193, 254 (1979) (Rehnquist, J., dissenting) ("Finding the desired result hopelessly foreclosed by these conventional sources, the Court turns to a third source - the 'spirit' of the Act. But close examination of what the Court proffers as the spirit of the act reveals it as the spirit animating the present majority, not the 88th Congress.").

[9] See, e.g., Loral Corp. v. United States, 434 F.2d 1328, 1330 (Ct. Cl. 1970) ("[T]he type of contracts in question are firm fixed-price contracts and once the price was agreed upon, that price remains fixed and it is not subject to further negotiation, unless otherwise provided in the contract."); see also 48 C.F.R. § 16.202-1 ("A firm fixed-price contract provides for a price that is not subject to any adjustment on the basis of the contractor's cost experience in performing the contract."); cf. ITT Fed. Servs. Corp. v.

perform, or for deliberately underbidding, is on the contractor, not the Government.[10]

AT&T now seeks to take advantage of the fact that the deal it made with the Government did not result in an enforceable contract, which it likely knew (and certainly should have known) when it proposed to enter into the agreement. AT&T demands more money for what it has been fully paid to do. The answer to that facially nonsensical demand is, in a word, "no."

Perhaps the court thought it could not get there if, in accordance with the statute, it held the contract invalid. Actually, the right answer is not that difficult, even accepting the fact that there is no legally-enforceable contract between the parties. AT&T argues that, since the contract it made is unenforceable, it should be treated as having an "implied-in-

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Widnall, 132 F.3d 1448, 1451 (Fed. Cir. 1997) (holding that ITT was not entitled to recovery of normal severance costs because in a firm, fixed-price contract situation, the contractor assumes responsibility for all such costs that may be incurred).

[10] See, e.g., ITT, 132 F.3d at 1451 (Fed. Cir. 1997) (agreeing with the ASBCA that in a firm fixed-price contract situation, the contractor "assumes maximum risk and full responsibility for all such costs that may be incurred"); see also 48 C.F.R. § 16.202-1 (placing upon the contractor "maximum risk and full responsibility for all costs and resulting profit or loss"); cf. Emerald Maintenance, Inc. v. United States, 925 F.2d 1425, 1430 (Fed. Cir. 1991) (noting that the risk of loss was on the contractor who "should not be compensated for incurring added expenses resulting from assuming that risk").

fact" contract, a key term of which would be different from that to which the parties actually agreed. The different term would be that the contract would not be for a fixed price, but instead would be a cost-plus contract. That would take the contract outside the scope of § 8118, and give AT&T a rightful claim to all the money for which it asks.

That would also make nonsense out of the concept of an implied-in-fact contract. An implied-in-fact contract is a form of consensual contract, reflecting the basic requirements for such a contract including that of a meeting of the minds. It differs from the usual express contract only in that the terms, instead of being expressly stated by the parties, are derived from their conduct. Nothing here in the conduct of the parties suggests an agreement to have a cost-plus contract; on the contrary, the parties specifically stipulated to a fixed price-type contract.

If AT&T is to have any remedy entitling it to more than what it has been paid, its claim must be based on some sort of equitable claim for payment for goods sold and delivered, a *quantum valebat* claim.[11] Even assuming for discussion purposes that the Court of Federal Claims could exercise the powers of a court of equity, AT&T has no equity on its side, and therefore is not entitled to the intervention of a court of equity.

AT&T comes to the court with unclean hands. AT&T is not an innocent bystander being taken advantage of by a

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[11] An action for goods sold and delivered, "founded on an implied *assumpsit* or promise, on the part of the defendant, to pay the plaintiff *as much as* the goods were reasonably *worth.*" Black's Law Dictionary 1244 (6th ed. 1990).

predator government. Both the Government and AT&T knew exactly what they were doing when they entered into this deal. It simply defies belief that AT&T was unaware of § 8118 when it purported to contract with the Government or was unaware that the Navy was proceeding with the contract in the manner the Navy did.

In any event, that does not matter. The most that AT&T would be entitled to under any equitable theory is the fair value of the goods sold, and that value was agreed to by AT&T when it made the deal with the Navy. The goods are one-of-a-kind, not to be found on the shelf at your usual military equipment supermarket. There can be no better method for determining a fair price for the goods than to see what a willing seller would sell them for to a willing buyer.

AT&T does not allege that it was coerced by the Government, or that it was caused to enter into the deal by fraud. It simply wants more money for a product it agreed to provide for a price that proved, according to AT&T, too low. An inefficient, wasteful, or simply ignorant contractor cannot foist off on the other contracting party the consequences of its own incompetence.[12] The law in a case like this leaves the

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[12] It should be obvious that, just as AT&T could not claim additional payment for goods for which it has been fully paid, it could not claim ownership of the goods for purposes of recovering them, for example, in a replevin action. A suggestion to the contrary could not be taken seriously. Even if the law would contemplate it, it is hard to imagine a major American contractor, whose fiscal lifeblood comes in substantial measure from contracts with the United States Government, even thinking about replevying a secret government weapon for resale elsewhere. Money is one thing; fiscal suicide is another.

parties where it found them.[13]

The en banc court appears unwilling to give AT&T any more money on its so-called non-contract claim. As I said at the beginning, a court has a responsibility to arrive at the right result, but also an obligation to do no harm to the fabric of the law. A wrong result is an injustice to one party; distorting important legal principles is a disservice to the entire legal system.

It is true that statutory interpretation does not occur in a vacuum. Words take meaning from the context in which they are used, and, when text and context yield genuine doubt, courts may seek guidance from accepted canons, from history, and from legislative purpose when it can be authoritatively known. In many cases, construing Congressionally-mandated language is as much an art as it is linguistic science. But it is not an art in which the picture that emerges is without constraints, or is limited only by the imagination of the artist.

There is an established methodology that courts employ in construing statutes. As the quoted excerpts from the Supreme Court show, the methodology is well-recognized, even if judges do not always agree on how much

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[13] See, e.g., Keystone Driller Co. v. General Excavator Co., 290 U.S. 240, 245 (1933) ("A court of equity acts only when and as conscience commands; and, if the conduct of the plaintiff be offensive to the dictates of natural justice, then, whatever may be the rights he possesses, . . . he will be held remediless in a court of equity." (internal quotations omitted) (quoting Deweese v. Reinhard, 165 U.S. 386, 390 (1887))).

weight to give to its various parts in a given case.[14] The methodology is designed to provide guidance for the exercise of judicial self-discipline, the self-discipline that produces principled decisions.

This court has in the past expressly recognized the governing principles: "A statute is by definition the law to be followed - not disregarded, effectively repealed, rewritten, or overruled (unless unconstitutional) - in the federal courts," In re Mark Indus., 751 F.2d 1219, 1224 (Fed. Cir. 1984), and recently reiterated the point: "This court is empowered to rewrite neither statutes nor regulations, however unwise, nor does it have the information base nor expertise to do so effectively," Newport News Shipbuilding & Dry Dock Co. v. Garrett, 6 F.3d 1547, 1558 (Fed. Cir. 1993).

In sum, since the statute before us is not ambiguous and its application to the case would not require an absurd result, there is neither reason nor justification for reaching beyond the statute to legislative history or supposed purpose in order to find a different answer. Further, what little known legislative history there is I find inapposite and unpersuasive.

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[14] The methodology of statutory interpretation, with all its ramifications, has become one of the darlings of academic discourse, and is offered as a proper subject of study in many of the leading law schools, taught from modern-day casebooks. See, e.g., William D. Popkin, Materials On Legislation: Political Language and the Political Process (Found. Press 2d ed. 1997); William Eskridge & Philip Frickey, Cases and Materials on Legislation - Statutes and the Creation of Public Policy (West Pub. Co. 2d ed. 1995); Abner Mikva & Eric Lane, Legislative Process (Little, Brown 1995)..

Accordingly, I believe it is our duty to apply the statute as it has been given to us by Congress.

Thus, my answers to the questions certified are: (1) yes, the contract is null, void, and necessarily invalid, as the Court of Federal Claims correctly concluded; and (2) no, AT&T is not entitled to any equitable or other remedy on the facts presented, even if the Court of Federal Claims had power to grant such a remedy. I respectfully dissent from the court's contrary view.

UNITED STATES COURT OF APPEALS
FOR THE
FEDERAL CIRCUIT

95-5153, - 5154

AMERICAN TELEPHONE AND
TELEGRAPH COMPANY,

Plaintiff-Appellant,

v.

UNITED STATES,

Defendant/Cross Appellant.

ORDER

A combined petition for rehearing and suggestion for rehearing in banc having been filed by the appellant, and a response thereto having been invited by the court and filed by the cross appellant, and amicus having been granted leave to file a brief in support of the appellant's combined petition for rehearing and suggestion for rehearing in banc, and the petition for rehearing having been referred to and acted upon by the panel that heard the appeal, and, thereafter, the suggestion for rehearing in banc having been referred to the judges in regular active service to determine whether the appeal should be reheard in banc, and a poll having been requested, it is

ORDERED that the petition for rehearing is denied, and it is further

ORDERED that the suggestion to rehear the appeal in banc is accepted; the judgment of the court entered on September 24, 1997, and reported at 124 F. 3d 1471, is vacated; and the opinion of the court accompanying the judgment is withdrawn;

IT IS FURTHER ORDERED that new briefs shall be filed. Appellant's principal brief is due within 60 days of the date of filing of this order. The court sua sponte allows the amicus to file a brief at that time. The dates for filing the remaining briefs shall be in accordance with Fed. Cir. R. 31(a). An original and 30 copies of all briefs shall be filed and two copies shall be served on opposing counsel.

Oral argument will be scheduled by later order.

FOR THE COURT

3/9/98 /s/
Date Jan Horbaly
Clerk

cc: C. Stanley Dees, Esq.
Bryant G. Snee, Esq.
Caryl A. Potter, III, Esq.

United States Court of Appeals for the Federal Circuit

95-5153, -5154

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,

Plaintiff-Appellant,

v.

THE UNITED STATES,

Defendant/Cross-Appellant.

DECIDED: September 24, 1997

Before NEWMAN, PLAGER and RADER, Circuit Judges.

Opinion for the court filed by Circuit Judge PLAGER. Dissenting opinion filed by Circuit Judge NEWMAN.

PLAGER, Circuit Judge.

Congress prohibited the expenditure by the Department of Defense ("DOD") of federal funds for certain types of research and development contracts. This case is about the consequences, legal and financial, to a contractor and to the Government when they perform a purported contract made in apparent violation of the Congressional prohibition of expenditure of money in that manner.

American Telephone and Telegraph Company ("AT&T") entered into a contract with the United States ("Government") for a fixed-price contract involving research, development and production of a ship-towed, undersea surveillance system known as the Reduced Diameter Array ("RDA"). AT&T, claiming that it incurred expenses exceeding the contract's fixed price by several multiples, submitted to the contracting officer a claim for recovery of these added expenditures. The claim was denied.

AT&T filed for recovery in the United States Court of Federal Claims. The Court of Federal Claims, in response to the parties' cross motions for summary judgment, concluded that the contract was void as a matter of law and could not be reformed as requested by the contractor. The court held, however, that the contractor might be entitled to the remedy of quantum meruit, measured by the value of goods and services received by the Government. American Telephone & Telegraph v. United States, 32 Fed. Cl. 672, 682-83 (1995).

Because the trial court's ruling confronted the parties with the prospect of an extended trial on whether the Government had been unjustly enriched, and if so by how much, and because the ruling placed in doubt the legality of a large number of DOD contracts of a similar nature, the trial court certified, and we accepted, the case for interlocutory appeal. Both parties appeal the judgment of the trial court. We affirm-in-part and reverse-in-part.

BACKGROUND

The ability to locate enemy submarines within broad ocean areas has been considered the single most important element of an effective antisubmarine warfare system. The Reduced Diameter Array is part of the larger Surveillance Towed-Array Sensor System ("SURTASS"), which provides undersea surveillance of submarines. The SURTASS-equipped surface ship collects acoustic data by towing its electronic sonar array - a long, slender flexible hose, approximately 8,000 feet long, containing hydrophones and other sensors and electronics - through the ocean. Once the sonar array collects acoustic data, the SURTASS ship processes the collected data with its onboard electronics and transmits the data through its communications equipment to a satellite and ultimately to a shore-based facility. In the effort to monitor Soviet submarines, SURTASS was one of the Government's most important ongoing programs.

On December 31, 1987, the Navy awarded AT&T a fixed-price incentive fee contract with an initial contract ceiling price of $19 million for research and development of the RDA.[1] The RDA was to replace

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[1] Various dollar amounts are stated in the appellant's brief, the respondent's brief, and the Court of Federal Claim's opinion. For example, the Government states that offers were solicited with an estimated contract price of approximately $19 million, that at contract award a $2 million increment was added, and that AT&T's bid was for $29 million. AT&T states that the RDA contract was for $19 million. The trial court referred to the contract as having an adjusted ceiling price of $34.5 million. These numbers can no doubt be reconciled, but in view of our disposition, it is unnecessary for us to do so.

the existing SURTASS sonar array, which was based on older technology. In addition to basic research and development, the RDA contract provided for delivery and testing of a fully functioning engineering development model. The contract also contained an option for a second engineering development model and an option to purchase three production-level RDA subsystems. Both options have been exercised by the Navy.

At the time this suit was filed, performance of the contract was essentially complete. The work, however, was considerably more costly than the parties had anticipated, or at least than the contract contemplated. Despite AT&T's pleas to the Government not to elect purchase of the production-level units because of the cost overruns already experienced by AT&T, the Government ordered and AT&T produced in accordance with its contract three RDA units, all of which were delivered under the RDA contract.

Over the course of the contract the agreed contract price increased to $34.5 million. Even so, AT&T claims to have incurred much higher contract costs, approaching $101 million. After its claim for reimbursement by the Government for its extra costs was rejected by the contracting officer, AT&T filed suit in the Court of Federal Claims, seeking approximately $60 million in extra costs.

In its opinion, the Court of Federal Claims held that the contract was invalid because, under § 8118 of the Department of Defense Appropriations Act, Pub. L. No. 100-202, § 8118, 101 Stat. 1329, 1329-84 (1987), the Government had no authority to enter into such a contract. However, citing United States v. Amdahl, 786

F.2d 387 (Fed. Cir. 1986), the trial court concluded that it had jurisdiction to award relief based on a theory of unjust enrichment, and announced its intention to engage in fact-finding to determine if the failure to grant relief to AT&T would "unjustly" enrich the Government, and if so, by how much. Both the Government's motion to dismiss or for summary judgment, and AT&T's motion for partial summary judgment were denied.

In response to the parties' concerns with this disposition of their motions, the trial court agreed to certify under 28 U.S.C. § 1292(d)(2) an interlocutory appeal from its order, and we accepted the case for interlocutory appeal.

DISCUSSION

A. The Statute

1.

When enacting the annual appropriations bills for the various federal agencies, Congress often incorporates instructions regarding use of the funds for specific purposes. In 1987, the bill, which contained the appropriation for the Department of Defense, contained instructions, inter alia, for further development of the SDI research program, for expeditious development and operational testing by the Army of the M72E4 weapons program, for the lifting of monetary limits on vehicles purchased for intelligence activities, and for prohibiting the obligation and expenditure of funds for certain fixed price-type contracts. This last provision was § 8118 of the bill, and read:

> None of the funds provided for the Department of Defense in this Act may be obligated or expended for fixed price-type contracts in excess of $10,000,000 for the development of a major system or subsystem unless the Under Secretary of Defense for Acquisition determines, in writing, that program risk has been reduced to the extent that realistic pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties: Provided, That the Under Secretary may not delegate this authority to any persons who hold a position in the Office of the Secretary of Defense below the level of Assistant Under Secretary of Defense: Provided further, That the Under Secretary report to the Committees on Appropriations of the Senate and House of Representatives in writing, on a quarterly basis, the contracts which have obligated funds under such a fixed price-type developmental contract.

Pub. L. No. 100-202, § 8118, 101 Stat. 1329, 1329-84 (1987). The parties do not dispute that the contract at issue here is a fixed price-type developmental contract in excess of $10,000,000, and that the Under Secretary did not make the determination, or the report, required for such fixed price-type contracts. Nor is there any dispute about the fact that the contract was entered into after the enactment of § 8118, and that at least some if not virtually all of the funds paid to AT&T under the contract came from appropriations subject to the proscription of § 8118.[2] They do disagree about two

[2] The prohibition contained in § 8118 was repeated in essential respects in subsequent years' appropriations acts through 1993.

key issues: first, whether the contract is encompassed within the terms of § 8118, specifically, whether it is for "a major system or subsystem"; and, second, even if it is, what are the consequences.

AT&T argues that the contract falls squarely within the terms of § 8118, that is, the RDA is a major system or subsystem, and therefore the contract is invalid as written. According to AT&T, the contract should be rewritten by the court to permit payment as a cost-based type contract, which is what Congress must have intended. (Though the parties do not expressly so state, presumably a cost-based type contract would entitle AT&T to be paid by the Government for all its allowable costs in performing the contract, plus an appropriate profit margin.) As an alternative, AT&T argues it is entitled to equitable relief, under a theory of quantum meruit, for the money it spent in performing the contract.

The Government takes the position that the RDA project that is the subject of the contract at issue is not a "major system" as that term is defined elsewhere in the law, and that therefore § 8118 does not apply to it. Even if it does apply, a violation of the statute does not render the contract void simply at the behest of a contractor, argues the Government, and thus AT&T is entitled to nothing more than the contract permits.

Our first task, then, is to determine whether the contract entered into between the parties was a contract for a "major system or subsystem," and thus subject in the first instance to the prohibitions of § 8118. In the absence of a definition in the section itself, and because the phrase cannot be said to have a

"plain meaning," we take a brief excursion into the history of § 8118 to help understand what Congress intended when it added that provision to the Appropriations Act.

2.

For decades, policy debates concerning the most advantageous contract type for large scale, cutting-edge weapons systems' research and development projects have occurred within the DOD and its constituent services. These debates reflect, in part, the tension between the desire to foster the free market and competitive goals embodied by fixed price-type procurement, and the desire to accommodate the uncertainty inherent in such cutting-edge research and development efforts.

Defense Department acquisition policy has reflected these debates, and has vacillated between the use of cost-based type and fixed price-type contracts. Because the development of cutting-edge weapons systems often involves unknown technical risks having unknown solutions at the time they become known, the problem centers on finding a mechanism for reasonably allocating the risks inherent in such efforts, while protecting the Government from open-ended liability for uncontrolled spending.

In the 1960s the DOD followed a policy of fixed-price development contracting under the "Total Package Procurement" concept. Although in theory this policy would increase competition and cost discipline, in practice, because of the inherent risks in such programs, it resulted in program delays, contractor claims, and protracted litigation. See generally Norman

R. Augustine & Robert F. Trimble, Procurement Competition at Work: The Manufacturer's Experience, 6 Yale J. on Reg. 333, 345-47 (1989); see also Surveys & Investigations Staff, Report to the Committee on Appropriations, U.S. House of Representatives, on Navy Fixed Price Contracting in the RDT&E Account, 100th Cong. , 1st Sess. ii (1987).

In 1971, DOD Directive 5000.1 prohibited Total Package Procurement and established a policy favoring the use of cost-based type contracts for development efforts. This policy was reflected also in the Federal Acquisitions Regulations governing R&D contracts. See 48 C.F.R. § 35.006(c) (1996). In the mid-1980s, however, the Navy returned to fixed-price contracting for certain types of development contracts. Congress became aware of this. After an investigation by the House Appropriations Committee staff and hearings before the Defense Subcommittee of the House Committee on Appropriations, at which the Navy's current practice was identified with the unsatisfactory experience of the past, the House inserted language into the 1988 DOD appropriations bill which, as modified in the conference between the House and Senate committees, became § 8118. The modified language was included in the 1988 Continuing Appropriations Act, Pub. L. No. 100-202, 101 Stat. 1329 (1987), enacted December 22, 1987.

The original version in the House bill contained, in addition to the requirement of Under Secretary approval, a requirement that the Under Secretary provide advance notice to Congress of the intention to authorize such a contract. In the enacted § 8118 and its progeny, that requirement was eased to one of after-the-fact reporting.

With regard to th . ase "major system or subsystem," the original House version denied funding to "fixed price-type contracts for the development of a major system or subsystem." The enacted version substituted the phrase "fixed price-type contracts in excess of $10,000,000 for the development of a major system or subsystem." Neither version incorporated a definition of the phrase, or otherwise explained its meaning.

Both the House report by the House Committee on Appropriations and the report of the conference committee made it clear that the purpose of the new provision was to express Congress's unhappiness with the continued use of fixed price-type contracts for R&D procurements, and in particular with the Navy's practice which was seen as inconsistent with DODD 5000.1. See Surveys & Investigations Staff, Report to the Committee on Appropriations, U.S. House of Representatives, on Navy Fixed Price Contracting in the RDT&E Account, 100th Cong. , 1st Sess. ii (1987). ("Although Navy officials at the headquarters level have predicted immense success for the acquisition policy, . . . fixed price contracting . . . [has] generally proved unsuitable in an R&D environment."); H.R. Conf. Rep. No. 100-498, at 624 (1987) ("Fixed price contracts are normally not appropriate for research and development phases.").

The Government argues that, despite the obvious effort by Congress to bring this contracting activity within defined limits, the statute does not apply to the RDA contract. This is because, argues the Government, the RDA is not a "major system." This argument is bolstered by a memorandum issued by the

Under Secretary of Defense for Acquisition some six weeks after passage of the 1988 Act, defining the term "major system" by reference to a definition contained in a different and pre-existing part of the laws governing DOD acquisitions: "[t]he definition of major system at 10 U.S.C. § 2302(5) is the definition of that term for the purpose of this section [i.e., § 8118]." Under Secretary of Defense for Acquisition Costello, Memorandum for Service Acquisition Executives, Directors of the Defense Agencies 1 (Feb. 11, 1988). Since the contract for the RDA system is less than $75,000,000, the minimum threshold under § 2302(5), and, as discussed below, does not otherwise fit the statutory definition, the Government concludes that AT&T's contract is not within the scope of § 8118.

Section 2302(5), defining the term "major system," appears in the definitions section of the general procurement chapter, chapter 137, of Subtitle A - General Military Law, of Title 10, Armed Forces. 10 U.S.C. § 2302(5) (1994). By its terms, the definitions section is applicable to the various sections and subsections of chapter 137. The question is, does it have applicability to § 8118 of the 1988 Continuing Appropriations Act? A reading of § 2302(5), as it stood at the time of the events involved here,[3] suggests that its purpose is to provide guidance in the procurement of a wide range of goods and' services:

> The term "major system" means a combination of elements that will function together to produce the capabilities required to fulfill a mission need. The elements may include

[3] Subsection 2302(5) was amended in 1996. See Pub. L. No. 104-201, 110 Stat. 2605 (1996).

> hardware, equipment, software or any combination thereof, but excludes construction or other improvements to real property. A system shall be considered a major system if (A) the Department of Defense is responsible for the system and the total expenditures for research, development, test, and evaluation for the system are estimated to be more than $75,000,000 (based on fiscal year 1980 constant dollars) or the eventual total expenditure for procurement of more than $300,000,000 (based on fiscal year 1980 constant dollars); (B) a civilian agency is responsible for the system and total expenditures for the system are estimated to exceed $750,000 (based on fiscal year 1980 constant dollars) or the dollar threshold for a "major system" established by the agency pursuant to Office of Management and Budget (OMB) Circular A-109, entitled "Major Systems Acquisitions", whichever is greater; or (C) the system is designated a "major system" by the head of the agency responsible for the system.

10 U.S.C. § 2302(5) (1988).

It is not immediately obvious that Congress, in adding the prohibition of § 8118 to the 1988 DOD appropriation, intended to limit the section's remedial effect only to those contracts which fall within the specific terms of § 2302(5). In addition to the general thrust of § 8118, and the legislative history that preceded and accompanied its enactment, the introduction of the $10,000,000 threshold suggests that Congress was more focused on the size of the specific contract than on the size of the overall project, the

latter being the basic standard of the definition contained in § 2302(5).

If Congress's concern is for the consequences of fixed price-type contracts involving R&D, with a specific dollar ceiling, the size of the overall program would seem largely irrelevant. Furthermore, the statutory definition specifically permits the head of the agency responsible for the system to designate a system as a "major system," or, presumably, not to designate so. Given Congress's displeasure with the Navy's activities in this regard, it seems implausible that Congress would purposely grant that discretion to the agency head whose conduct it was trying to control.

There is a further difficulty with the Government's heavy reliance in this case on the Under Secretary's memorandum and the definition contained in § 2302(5). That definition is only of the term "major system." Nothing is said about the term "subsystem" with which "major system" is coupled in the Appropriation Act's § 8118. The Government in its brief refers to the "RDA contract," and occasionally to the "RDA system." AT&T consistently refers to the subject of the contract as the "RDA subsystem." Neither party favors us with an explanation of why one term is more appropriate than the other.

On its face, the term "subsystem" would appear to be the more appropriate one. Both the Government and AT&T appear to view the RDA as being a part of the larger SURTASS submarine surveillance system. Yet even calling it a subsystem does not solve the statutory interpretation problem. There remains the question of whether Congress intended the adjective "major" to apply both to "system" and to "subsystem."

And even if the phrase should be read as if it said, "major system or major subsystem," in absence of a statutory definition of a "major subsystem," is RDA such a subsystem? All of which suggests that Congress may not have had in mind the definition in § 2302(5) when it used the phrase "major system or subsystem" in § 8118.

When Congress enacts legislation establishing a regulatory program and leaves to the agency broad discretion in the manner in which the program, or aspects of it, are to be implemented, it is for the agency, and not the courts, to decide how that discretion is to be exercised. Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843-44 (1984). If the exercise of discretion is a properly considered and promulgated action by the agency, and within the range of permissible choice, courts will not substitute their judgment for that of the responsible agency official. See, e.g., Merk & Co. v. Kessler, 80 F.3d 1543, 1549 (Fed. Cir. 1996); Federal Mogul Corp. v. United States, 63 F.3d 1572, 1579 (Fed. Cir. 1995). The Government argues that the Under Secretary's memorandum incorporating the statutory definition of § 2302(5) into § 8118 should be given such deference.

In addition to the fact that the Under Secretary's memorandum addresses only the definition of a major system, not a subsystem, there is a further problem with this argument. The prohibition on Government conduct here is not a delegation of broad discretion to an agency. On the contrary, it is an express limitation upon governmental discretion, and is designed to inhibit the conduct of the very official who is claimed to have the discretion to interpret the provision as he sees

fit. We cannot see in this legislation an intent to permit agency discretion of that order.

Taking into consideration the history of § 8118, and above all its phrasing, we conclude that Congress intended this prohibition to have the effect of significantly limiting the ability of the DOD, and in particular the Navy, to enter into these fixed price-type R&D contracts for significant projects, and that the Congressional purpose best can be realized by construing the phrase "major system or subsystem" to have the ordinary meaning such a phrase connotes, and not the technical meaning that would be ascribed by an application of § 2302(5). Reading "major system or subsystem" in its ordinary sense, the RDA contract here, substantially exceeding the $10,000,000 ceiling, and having a significant role in the upgrading of the SURTASS program, easily falls within the scope of the § 8118 provision.

The Government's argument before us to the contrary notwithstanding, this reading of § 8118 will not come as a surprise to senior officials in the DOD. In March 1991, the newly-appointed Director of Defense Procurement in the DOD spoke to the defense procurement community at a conference in Williamsburg, Virginia. Among other topics, she reviewed the history of the DOD's fixed price-type R&D contracting. She concluded the discussion by saying:

> The negative consequences of the inappropriate use of fixed-price development contracts have become so clear that the department's senior management has said "no more." The Under Secretary of Defense for Acquisition now personally approves any

> planned fixed-price development contract in excess of $25 million (and those over $10 million, on a major program). However, the consequences of the large, long-term fixed price development contracts that were awarded several years ago will be with us for years to come.

Eleanor R. Spector, Address at the Department of Defense Procurement Conference (Mar. 20, 1991).

It is clear that the Department viewed the problem as primarily keyed to the individual R&D contract, and treated the concept of major programs in its generic sense. Her prophetic concluding words, reflecting the purpose behind Congress's enactment of § 8118, are borne out by this litigation. The decision of the Court of Federal Claims on this point is affirmed.

B. The Relief Available

Logically, the next question is, what is the legal consequence when parties attempt to create a contract in the face of a prohibition such as that contained in § 8118. AT&T argues that the statute prohibits the contract as a fixed price-type contract, and as a consequence the contract is illegal and thus void. Since the Navy only had one legally-supportable basis for awarding the RDA contract - to award it as a cost-based type contract - it follows, argues AT&T, that the requirements of § 8118 were, by operation of law, incorporated into the RDA contract; for purposes of granting AT&T a remedy the contract should be understood as a cost-based type contract.

The Government responds that, even assuming that § 8118 applies and was violated, that violation cannot render the completed RDA contract void. This is for three reasons: (1) no authority holds or suggests that circumstances such as these can result in a contract being declared void from its inception at the insistence of the performing contractor; (2) the authorities that do address contract invalidity and allocation of risk preclude such a holding; and (3) the circumstances of this case present no reason to create a sweeping new basis upon which to challenge the enforceability of a contract with the United States.

In analyzing the problem, it is important to keep clearly in mind what is meant when a contract is termed "illegal," a term used with abandon in the parties' briefs. That term encompasses a broad range of possible defects in contractual arrangements, from contracts that are inherently unenforceable (a contract to murder someone), to contracts in which one party is incompetent to contract (due to age or mental infirmity), to contracts in which a necessary term is omitted (such as price or date of performance), to contracts which are in some respect in violation of a positive rule of law (such as the case here).

The Government argues that the cases that have held contracts to be void or invalid upon the basis of a statutory or regulatory violation have involved provisions that explicitly limited the very authority of the parties to enter into the contract, or expressly prohibited the contract altogether. See, e.g., Clark v. United States, 95 U.S. 539, 542 (1877); Urban Data Sys., Inc. v. United States, 699 F.2d 1147, 1150 (Ct. Cl. 1983); Alabama Rural Fire Ins. Co. v. United States, 572 F.2d 727, 729 (Ct. Cl. 1978). The

Government notes that none of the "illegality" cases cited by AT&T deal with funding deficiencies. In the Government's view, a restriction on the availability of funding is not tantamount to a lack of authority to contract. Therefore, concludes the Government, § 8118 does not render the RDA contract void from its inception.

AT&T responds that the question is not whether § 8118 restricted the Navy's ability to fund fixed price-type development contracts, but whether the restrictions on the use of funds contained in § 8118 were "mandatory." If so, argues AT&T, citing New England Tank Indus., Inc. v. United States, 861 F.2d 685 (Fed. Cir. 1988), a contract entered into in violation of § 8118 is illegal and void.

The Court of Federal Claims concluded that § 8118's requirement for a written determination upholding the pricing integrity of a fixed-price development contract operates as a constraint on the contracting process intended for the protection of both Government and contractor. We agree with the Court of Federal Claims on this point, and affirm its conclusion. The congressional purpose is abundantly clear: "None of the funds provided . . . may be obligated or expended for [certain] fixed price-type contracts." Department of Defense Appropriations Act, Pub. L. No. 100-202, § 8118, 101 Stat. 1329, 1329-84 (1987). The attempt by the Navy to obligate or expend funds for a contract not properly authorized by Congress is ineffective to either commit or make use of federal dollars. See, Office of Personnel Management v. Richmond, 496 U.S. 414, 424, 427-28 (1990). The Government's attempt to contract fails. No valid contract was or could be entered into in face of the

express congressional prohibition. See, e.g., 31 U.S.C. § 1341 (1994) ("Limitations on expending and obligating amounts" (the "Anti-deficiency Act")).

The remaining question is what follows from the conclusion that the "contract" between the parties was an invalid attempt to enter into a contract. AT&T agrees that the contract was void ab initio, but seeks reformation of the contract into a cost-based type contract. The trial court correctly differentiated between an otherwise valid contract that contains a prohibited term or clause and one that is void from the inception. The court noted that the former may be amenable to reformation, but that a court has no power to remake that which was never established in the first instance. 32 Fed. Cl. at 682 (citing Hedges v. Dixon County, 150 U.S. 182, 192 (1893)).

The position on this issue taken by AT&T is internally inconsistent. Even if we grant that the effect of § 8118 is to cause the DOD to prefer cost-based type contracts for R&D efforts over the fixed price-type, that implicit preference resulting from the statute does not rise to the level of an expressly mandated contract provision making an attempt to contract one way become something else. Congress knows how to impose mandatory provisions in contracts. It did not do that in § 8118. The determination of the trial court that the contract is void and not subject to reformation is affirmed.

The trial court, however, did not end the case there. The court concluded that the consequence of its determinations was to leave the parties with an implied-in-fact contract, with compensation to be awarded on a quantum meruit basis. We cannot agree. The concept

of implied-in-fact contract is not for the purpose of salvaging an otherwise invalid contract. An implied-in-fact contract arises when, in the absence of an express contract, the parties' behavior leaves no doubt that what was intended was a contractual relationship permitted by law. Trauma Serv. Group v. United States, 104 F.3d 1321, 1326 (Fed. Cir. 1997). In the case here, the contractual relationship was not permitted by law, and the rubric of implied-in-fact contract is not appropriate.

On the basis of the implied-in-fact contract, the trial court announced its intention to grant quantum meruit relief. It is well established that the Court of Federal Claims does not have the power to grant remedies generally characterized as those implied-in-law, that is, equity-based remedies, as distinct from those based on actual contractual relationships. Hercules, Inc. v. Unites States, 116 S. Ct. 981, 985 (1996); Trauma Serv. Group, 104 F.3d at 1324-25. Quantum meruit is the name given to an implied-in-law remedy for unjust enrichment. As a general rule, it falls outside the scope of relief available through the Court of Federal Claims. Id.

The trial court cited the 1986 Federal Circuit case of United States v. Amdahl Corp., 786 F.2d 387 (Fed. Cir. 1986), as a basis for quantum meruit relief. In that case, the Federal Circuit stated that although the contract at issue in the case was invalid, the contractor was "not entirely without remedy" because:

> Where a benefit has been conferred by the contractor on the government in the form of goods or service, which it accepted, a contractor may recover at least on a quantum

> valebant or quantum meruit basis for the value of the conforming goods received by the government prior to the rescission of the contract for invalidity.

Id. at 393. However, Amdahl is distinguishable from plaintiff's situation because contracting authority was not at issue in the case. The contract in Amdahl was eventually rescinded not because the government representative lacked authority, but because its continued performance violated statutory and regulatory requirements. If the Government attempts to contract without authority, as in this case, there can be no contract on which to award relief for partial performance. While it is true that the Amdahl court discussed the matter under the heading of quantum meruit, the circumstances of the case suggest it was more properly labeled equitable relief allowed under the Contract Disputes Act, 41 U.S.C. §§ 601-613, when a contract, express or implied-in-fact, is present.

Since AT&T never had a contract with the Government, and it is not entitled in an action in the Court of Federal Claims to relief based on a theory of unjust enrichment, AT&T has not stated a claim upon which relief can be granted. The Government is entitled to judgment in its favor. The decision of the trial court to the contrary, in which it would consider the award of relief to AT&T in this case, is reversed.

This is not to say that AT&T is without any remedy. It would appear that the Government is in possession of goods, the RDA equipment, originally manufactured and owned by AT&T. There is nothing to suggest that AT&T intended to make a gift of that equipment to the Government, and much to suggest

the contrary. Whether AT&T may replevy the goods, or bring an appropriate action for the value of its wrongful retention and use by the Government, is not before us.

CONCLUSION

The order of the Court of Federal Claims is affirmed-in-part and reversed-in-part. The matter is remanded to that court with instructions to grant judgment to defendant Government on AT&T's contract claim.

AFFIRMED-IN-PART, REVERSED-IN-PART & REMANDED.

United States Court of Appeals for the Federal Circuit

95-5153, -5154

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,

Plaintiff-Appellant,

v.

THE UNITED STATES,

Defendant/Cross-Appellant.

NEWMAN, Circuit Judge, dissenting.

AT&T and the Navy entered into a fixed price research and development contract relating to new and strategically essential technology for submarine detection. AT&T fully performed its contract obligations, at a cost that AT&T says was significantly higher than the contract fixed price. AT&T says that the Navy urged this performance, although research costs soared. AT&T raises the issue of appropriate compensation, for which it brought suit in accordance with the Contract Disputes Act.

The panel majority holds that AT&T never had any right to any payment for its work done under the contract, and that the Navy is off the hook for the massive benefits demanded and received, even had it

never paid a cent. The majority holds that because of the Navy's transgression in complying with congressional oversight requirements, "AT&T never had a contract with the Government." My colleagues hold that AT&T might now try to retrieve the electronic equipment from the Navy, but it can not be paid for it, even had there been no payment whatsoever.

It is undisputed that both AT&T and the Navy performed this contract over a period of nearly five years. It can not be correct for this court to charge AT&T with oversight responsibility for whether the Navy also carried out the internal assessment and approval that Congress asked it to do, or whether the Navy filed the reports with Congress that Congress requested. AT&T bore no responsibility for the Navy's compliance with these requirements, and indeed could not know if the Navy had complied. See E. Walters & Co. v. United States, 576 F.2d 362, 367 (Ct. Cl. 1978) ("The discipline to be administered in such cases is a responsibility of the cognizant procurement officials within the agency . . . .") It is inappropriate to assess AT&T with the consequences of the Navy's internal lapses, if indeed there were such. If the Navy did not fulfill its obligations to the Congress, it does not follow that "AT&T never had a contract with the Government," as my colleagues now rule.

Not every violation of a statute or regulation, nor the failure to comply with a congressional request for reports and internal approvals, renders a contract void or invalid -- particularly after it has been fully performed. The oversight requirements of §8118 of the Appropriations Act do not go to the core of federal procurement. Indeed, contracts between the government and a private party have been sustained

even when statutes and regulations relating to the procurement or award process have been violated. E. Walters, 576 F.2d at 367 ("the fact that a procurement practice is prohibited does not necessarily mean that it is therefore actionable"); see Walsh v. Schlecht, 429 U.S. 401, 408 (1977) (requiring preservation of the validity of contracts that are not plainly illegal); United States v. New York & Porto Rico S.S. Co., 239 U.S. 88, 92 (1915) (when government did not comply with formal requirements, contract not illegal and recovery permitted upon *quantum valebat* when performed) (citing United States v. R. P. Andrews & Co., 207 U.S. 229, 243 (1907)); Trilon Educational Corp. v. United States, 578 F.2d 1356, 1361 (Ct. Cl. 1978) (the fact that the contracting officer may have disregarded a directive of the ASPR does not ordinarily render the contract a nullity); Ocean Tech., Inc. v. United States, 19 Cl. Ct. 288, 294 (1990) ("Performance having been fully completed, holding the obligation to pay unenforceable is not a position favored in this circuit.").

In contrast, those contracts that have been held void or invalid on the ground of a statutory or regulatory violation have been clearly illegal in a material aspect, in that they violated provisions explicitly limiting the authority of a party to enter into the contract, or expressly prohibiting the contract altogether. E.g., Clark v. United States, 95 U.S. 539, 542 (1877) (unlawful for contracting officers to make contracts that violate the statute of frauds); Urban Data Systems, Inc. v. United States, 699 F.2d 1147, 1150 (Fed. Cir. 1983) (recovery based on implied-in-fact contract after contracts declared invalid because they contained pricing clauses in plain violation of statute); Alabama Rural Fire Ins. Co. v. United States, 572 F.2d 727, 729, 736 (Ct. Cl. 1978) (the statute creating the plaintiff

corporation expressly forbade plaintiff from entering contract).

However, §8118's assessment and reporting requirements neither limited the authority of the Navy to enter the Reduced Diameter Array contract with AT&T nor prohibited the use of a fixed price contract; the contract was not illegal and is not invalid. Indeed, the Navy agrees that invalidation of the contract is not available on the ground that the Navy failed to comply with internal approvals and reporting at the political level. In enacting §8118 Congress did not require, or even suggest, that a completed contract would be invalidated if the legislative goal of overseeing Defense Department research and development contracts were thwarted by inadequate defense agency compliance. Congress plainly stated the contrary intent:

> It is the intent of the committee that this section be applied in a manner that best serves the government's interests in the long term health of the defense industry, and that this section not be used as the basis for litigating the propriety of an otherwise valid contract.

S. Rep. No. 100-326, at 105 (1988) (referring to the 1989 reenactment of §8118).

In addition to stating that it did not intend litigation of an otherwise valid contract to result from §8118 restrictions, the legislative history demonstrates that Congress intended to monitor Defense Department usage of fixed price development contracts, not to prohibit their use entirely. By various amendments Congress adjusted the enforcement provisions of §8118 and successor enactments by simply changing the

nature and timing of the Department's reports to Congress. In enacting §8118 the congressional conferees explained that the remedy set by this legislation was the requirement for quarterly reports after contracts were let "instead of the more rigorous requirement of prior certification to Congress proposed by the House . . . [i]n order to reduce the appearance of congressional micromanagement of acquisition policy." H.R. Rep. No. 100-498, at 623 (1987). The Report stated that if Defense Department policy did not become more uniform, "more severe restrictions" would be imposed. Id. This carries no hint of, and indeed belies, the dramatic penalty of voiding a fully performed contract, as the panel majority now imposes.

The legislative history shows congressional concerns about the military's research and development acquisition policy, in the form of continuing review of Defense agency actions in this area and the imposition of specific and carefully considered reporting provisions. Congress did not, however, prohibit the making of fixed price R&D contracts. Compare 41 U.S.C. §254(b). Instead, if Congress remained unsatisfied with agency procurement practices, Congress expressed its willingness to hold hearings and (as it did when it enacted the 1989, 1990, 1991, 1992, and 1993 Defense Appropriations Acts) to alter the reporting and internal approval obligations.

It is not the judicial role to monitor executive agency reports to Congress, or to discipline the Navy's internal compliance with the oversight actions requested by Congress. Cf. Lonashore v. United States, 77 F.3d 440, 443 (Fed. Cir. 1996) ("Congress has undoubted capacity to oversee the performance of Executive Branch agencies, consistent with its constitutional

authority. It is not for this court to instruct Congress on how to oversee and manage its creations."); National Treasury Employees Union v. Campbell, 654 F.2d 784, 794 (D.C. Cir. 1981) (when Congress required investigation and reporting to Congress by the [Comptroller General], the court stated: "By means of this and other safeguards, Congress itself is in a position to monitor and enforce its spending limitations. It is not for us to question the effectiveness of the existing remedies and infer additional remedies . . . .") (footnote omitted).

Congress plainly did not intend that any lapse by the Navy in its compliance with §8118, a lapse that by its nature could not have been apparent to AT&T, could be invoked, after full contract performance, to strip the Navy of authority to have entered into the contract, and to strip AT&T of the right to present any claims arising from its performance of the contract. See John Reiner & Co. v. United States, 325 F.2d 438, 440 (Ct. Cl. 1963) (after award of the contract the "binding stamp of nullity" should only be imposed "when the illegality is plain").

In ruling that the Reduced Diameter Array contract is void, the Court of Federal Claims relied on an 1866 opinion of the Court of Claims. However, Curtis v. United States, 2 Ct. Cl. 144, 151-52 (1866), does not support the court's theory. Curtis involved a contract for the construction of a branch of the United States mint in San Francisco. Congress had enacted a statute limiting to $300,000 the cost to the government, and providing that "the government shall not be liable for [any] excess." When the contractor sought recovery of cost in excess of $300,000, the court stated:

> The statute became to the claimant notice in law and in fact that the expenditures could not be carried beyond certain bounds; and it was, moreover, by direct reference, stamped upon and made a part of the contract which is the foundation of the claimant's rights.

2 Ct. Cl. at 152. The court in Curtis did not void the contract ab initio because its cost was exceeded; it simply enforced the statute which limited the amount to be paid. That express provision, not lack of contracting authority, limited the contractor's recovery.

The eventual discovery by AT&T that the Navy may not have complied with the procedures of §8118 does not invalidate the contract. Neither AT&T nor the Navy has this option. The panel majority's retroactive invalidation of the Reduced Diameter Array contract is contrary to the rules of contract, contrary to precedent, and contrary to the statute on which the majority relies. The contract was not illegal, and it was fully performed. Thus I must, respectfully, dissent from the panel majority's ruling..

In the United States Court of Federal Claims

No. 93-483 C

Filed: June 29, 1995

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,	)
Plaintiff,	)
v.	)
THE UNITED STATES,	)
Defendant.	)

C. Stanley Dees, J. Keith Burt, Andrew Saunders, McKenna & Cuneo, Washington, D.C., Loretta A. Cecil, and Robert H. Camp, Greensboro, North Carolina, for plaintiff.

Brad Fagg, with whom were Assistant Attorney General Frank W. Hunger, Director David M. Cohen, Department of Justice, Washington, D.C., B.J. Plunkett, III, and, Stephanie L. Buser, Department of the Navy, for defendant.

ORDER

AMENDING OPINION OF FEBRUARY 7, 1995 TO PROVIDE CERTIFICATION FOR INTERLOCUTORY APPEAL PURSUANT TO 28 U.S.C. $ 1292(d)(2)

I

On February 7, 1995, this court issued an opinion in this case determining, among other issues, (i) that the Navy, in failing to conduct a technical risk evaluation before awarding plaintiff a research and development contract on a fixed-price incentive basis, had acted in violation of statutory restrictions governing the obligation and expenditure of appropriated funds, (ii) that the contract resulting from the Navy's award was void ab initio, and (iii) that plaintiff was to be compensated for its nearly-completed performance pursuant to an implied-in-fact contract with the amount of compensation to be determined on a quantum meruit basis. To facilitate the quantum meruit determination the court ordered further fact development, either by stipulation between the parties or by trial.

Both sides now come before the court requesting certification of the court's opinion under 28 U.S.C. § 1292(d)(2) to facilitate an immediate appeal. Under the criteria enumerated in the referenced statute, certification of an interlocutory order is appropriate when the order involves "a controlling question of law . . . with respect to which there is a substantial ground for difference of opinion and . . . an immediate appeal from that order may materially advance the ultimate termination of the litigation." In the judgment

of this court, this case warrants certification for immediate appeal.

II

The controlling questions in the case are:

(i) whether a contract executed in violation of statutory restrictions on the obligation and expenditure of appropriated funds may be declared void from the start at the instance of the performing contractor, and, if so,

(ii) whether compensation for benefits conferred upon the Government (pursuant to the voided contract) can be predicated on an implied-in-fact contract with the amount of recovery to be determined pursuant to unjust enrichment principles.

In this court's view, each of the above-stated questions, when examined in light of existing case law authority and the analyses deducible therefrom, could be answered differently than they are in the court's opinion of February 7, 1995. Thus, the possibility of a different outcome on appeal is not remote; and a different outcome on either question would end this litigation.

Given these considerations and the protracted trial proceedings now facing the parties as a consequence of the court's opinion of February 7, 1995, the allowance of an immediate appeal from that opinion would be in the interests of justice and judicial economy. Moreover, the benefits of such an appeal extend beyond the boundaries of the instant case. Defendant has advised that this court's ruling puts in doubt the legality of a large number of Department of

Defense contracts covered by appropriation restrictions of the sort involved in the instant case.

III

The three-prong test set forth in 28 U.S.C. § 1292(d)(2) is designed to weigh the relative benefits of an immediate appeal; thus the "three factors should be viewed together as the statutory language equivalent of a direction to consider the probable gains and losses of immediate appeal." 16 Charles A. Wright, et al., Federal Practice and Procedure § 3930, at 156 (1977); see 9 James W. Moore, et al., Moore's Federal Practice ¶110.22[2] (1995). This court has considered the burdens and benefits attendant to the allowance of an immediate appeal and is of the view that much can be gained by having the court of appeals address the controlling questions in the case on an interlocutory basis rather than at the conclusion of what could otherwise prove to be a much protracted lawsuit.

Accordingly, the court's opinion in the above-captioned case, issued February 7, 1995, is amended in accordance with 28 U.S.C. § 1292(d)(2), by adding the following:

> The court is of the view that this opinion involves controlling questions of law as to which there is substantial ground for difference of opinion, and that an immediate appeal from the opinion may materially advance the ultimate termination of the litigation.

/s/
John P. Wiese
Judge

In the United States Claims Court

No. 93-483 C

Filed: February 7, 1995

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,	)	Contracts: Contract Disputes Act -- definition of claim; Statutory restriction on obligation and expenditure of appropriated funds – deference owed administrative interpretation; Void contract – reformation, restitution, quantum meruit.
Plaintiff,	)	
v.	)	
THE UNITED STATES,	)	
Defendant.	)	

C. Stanley Dees, J. Keith Burt, Andrew Saunders, McKenna & Cuneo, Washington, D.C., Loretta A. Cecil, and Robert H. Camp, Greensboro, North Carolina, for plaintiff.

Brad Fagg, with whom were Assistant Attorney General Frank W. Hunger, Director David M. Cohen, Department of Justice, Washington, D.C., B.J. Plunkett, III, and Stephanie L. Buser, Department of the Navy, for defendant.

OPINION

WIESE, Judge.

On December 31, 1987, the Department of the Navy awarded plaintiff, American Telephone & Telegraph Company (AT&T), a fixed-price incentive fee contract involving research, development and production of a ship-towed, undersea surveillance system referred to as the reduced diameter array (RDA). In the successful performance of this contract, AT&T claims to have incurred contract costs approaching 101 million dollars - an amount far in excess of the contract's adjusted ceiling price of 34.5 million dollars. A claim for the recovery of these added contract expenditures was submitted to the contracting officer by AT&T on December 18, 1992. The claim was denied; the matter is now before this court for resolution.

The core proposition advanced by AT&T is that the Navy was prohibited by statute and regulation from contracting, on a fixed-price basis, for the procurement of research and development effort of the sort required under the RDA contract. A contract executed in violation of these prohibitions, plaintiff maintains, may be reformed by the court so as to conform with procurement policy directives - directives which, according to plaintiff, counsel the use of cost reimbursement contracts for research and development effort. Alternatively, should the court deem contract reformation an inappropriate remedy, plaintiff asks that its contract be declared a nullity and that it be compensated on a quantum meruit basis for the value of the benefit conferred

upon the Government under the voided contract. Defendant disagrees with these arguments claiming that the contract in issue represents a valid exercise of procurement authority. Additionally, defendant contends that plaintiff's claim, no matter its ultimate merit, is not ripe for judicial consideration because it was prematurely addressed by the contracting officer.

The arguments in support of these respective positions are offered here, first, through defendant's motion to dismiss for lack of jurisdiction or, alternatively, motion for summary judgment; secondly, through plaintiff's cross-motion for partial summary judgment. Having considered the parties' written submissions together with the points raised during oral argument, the court denies defendant's motion to dismiss and also the parties' motions for summary judgment.

FACTS

The RDA Contract

One of the means by which the United States Navy carries out the detection, classification, and bearing estimation of submarines is through an integrated undersea surveillance system known as SURTASS. SURTASS (which stands for surveillance towed-array sensor system) is a mobile, passive, acoustic surveillance sonar system comprised of integrated electronic and hardware arrays that operate in conjunction with ship and shore-based support facilities. Among these arrays is the subject of plaintiff's research and development contract – the SURTASS Reduced Diameter Array Subsystem. The RDA subsystem comprises the sonar segment of SURTASS; it includes shipboard and shore-based electronics, ship/winch interface, array tow cable, and the array itself - a long slender flexible hose, approximately 8,000 fete in length, containing hydrophones

and other sensors and electronics. This array is towed from a surface vessel referred to as the T-AGOS SURTASS ship.

In addition to designing of the RDA subsystem, the RDA contract provided for delivery and testing of an engineering development model. The contract also contained an option for a second engineering development model and an option to purchase three production-level RDA subsystems. Both options have been exercised by the Navy.

Design of the RDA subsystem has been completed, demonstrated and approved by the Navy. The first engineering development model has been delivered, as have substantial portions of the second engineering model, and delivery of the first production-level RDA subsystem is imminent. The equipment AT&T has delivered under the RDA contract is currently in use by the Navy.

Funding of the RDA Contract

The RDA contract was structured as a multi-year, incrementally-funded undertaking. At the time of award, funds for the start-up of the research and development effort were made available through an obligation of funds that drew upon appropriations authorized by the 1988 Department of Defense Appropriations Act. Pub. L. No. 100-202, 101 Stat. 1329 (1987).

Included in the text of that statute was a provision, section 8118, pertaining to the use of appropriated funds for fixed-price contracts exceeding $10,000,000 that involved development of a major system or subsystem. Section 8118 read in full as follows:

> None of the funds provided for the Department of Defense in this Act may be obligated or expended for fixed price-type

> contracts in access of $10,000,000 for the development of a major system or subsystem unless the Under Secretary of Defense for Acquisition determines, in writing, that program risk has been reduced to the extent that realistic pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties: Provided, That the Under Secretary may not delegate this authority to any persons who hold a position in the Office of the Secretary of Defense below the level of Assistant Secretary of Defense: Provided further, That the Under Secretary report to the Committees on Appropriations of the Senate and House of Representatives in writing, on a quarterly basis, the contracts which have obligated funds under such a fixed price-type developmental contract.

101 Stat. at 1384.

Provisions essentially identical to section 8118 have bean included in all Department of Defense appropriation statutes enacted since 1987.

Neither at the time of award of the RDA contract nor during the subsequent years when contract performance was on-going were any of the funds which the Navy expended for that contract effort made the subject of a section 8118 determination by the Under Secretary of Defense for Acquisition or his delegate.

AT&T's Claim

From an engineering and technical standpoint, AT&T's contract effort has been successful; from a financial standpoint it has not. Through the end of 1990 (approximately the mid-point of the contract period), AT&T experienced $24 million in losses on the contract and more were expected to follow.

In order to gain some relief from this situation and to help bring costs under control, AT&T contacted the Navy in 1991 asking the procuring activity (the Space and Naval Warfare Systems Command), not to exercise its production system options under the contract. AT&T's formal request for this relief was set forth in a letter to the Navy of August 21, 1991. The letter called attention to "statutory restraints on the use of R&D [research and development] funds for fixed price contracts" existing at time of contract award and to Department of Defense procurement policy (expressed in an April 15, 1991 memorandum by the Acting Under Secretary of Defense for Acquisition) cautioning against the use of "fixed- or ceiling-priced production options obtained before the start of full-scale development contracts."

The request for relief was not heeded. The Navy exercised the production option for three RDA subsystems on September 26, 1991, thus prompting AT&T to continue its search for financial relief. Accordingly, on August 31, 1992, AT&T met with a Navy contracting officer to seek an equitable adjustment under the contract. Again, however, relief was not forthcoming.

During this meeting, AT&T reasserted the position it had previously expressed to the Navy, namely, that the RDA contract violated statutory constraints governing the use of fixed-priced research and development contracts. This position was reemphasized in a follow-up letter that AT&T

forwarded to the contracting officer on September 16, 1992. Therein AT&T wrote:

> [I]t is clear that the RDA Contract was awarded in violation of the law. Since the RDA agreement was a development contract in excess of $10 million that was funded with fiscal year 1988 funds, it was subject to Section 8118 of the 1988 Department of Defense Appropriations Act. In spite of this coverage, the Navy did not comply with that Section in awarding the contract by admittedly failing to obtain the requisite statutory certification before its execution. Therefore, whether the RDA Contract is viewed as a product of mutual mistake, or illegal for violating Section 8118, AT&T is entitled to have the contract repriced and restructured. The law requires such remedial consideration though reformation of the existing agreement . . . or through recovery without regard to the original contract under the doctrine of quantum meruit.

The letter concluded by saying that "AT&T will submit a claim under the Contract Disputes ,Act for restructure and repricing of the RDA Contract as relief justified for the reasons set forth above."

On December 18, 1992, AT&T submitted a certified claim to the contracting officer asserting that the RDA contract was awarded in violation of Section 8118 and seeking to recover its then current losses, together with related fee, of $59,937,000. The claim "conclusion" read as follows:

> The RDA Contract should be reformed to comply with section 8118. Consistent with section 8118, the RDA Contract should be reformed to a cost-type contract providing for an estimated cost of $100,574,000 and a fixed fee of $13,502,000. Pursuant to reformation of the RDA Contract to a cost-type contract, AT&T is entitled to payment of $49,843,000 for the unpaid costs it has incurred in performing the Contract plus $10,094,000 in fee. If the RDA Contract is not reformed to comply with section 8118, the Contract is void and ab initio and AT&T is entitled to recover under quantum meruit the fair market value of the benefit it has conferred on the Navy to date. As of the end of October 1992, the amount of AT&T's recovery under quantum meruit is $59,937,000, which represents all of the unpaid costs it has incurred in performing the RDA Contract plus a reasonable profit. Since AT&T is continuing to perform at the government's direction, this amount will increase.

As happened twice before, AT&T's request for relief was not successful. In a final decision dated June 18, 1993, the contracting officer rejected AT&T's contention that the RDA contract was awarded in violation of the requirements of section 8118. Also rejected was the assertion that enforcement of the contract contravened DOD procurement policies that counseled against the use of fixed-price contracts for developmental efforts except where the appropriateness of such contracts was supported by highly credible cost and pricing data.

On August 3, 1993, AT&T filed its complaint in this curt seeking to recover $59,937,000, plus any additional costs and fee incurred in performing the RDA effort prior to judgment. The complaint alleges two counts. Count I asserts that the Navy awarded the RDA contract in violation of section 8118 and, in subsequent years, continued to obligate funds to the contract in violation of the successor provisions to section 8118. Count I also alleges that the RDA contract was awarded in violation of the Federal Acquisition Regulations and Department of Defense Directive 5000.1. As a result of these violations of law and regulation, AT&T seeks in Count I to have the RDA contract reformed to a cost-reimbursement contract or to recover the value of the benefit it conferred on the Navy under the doctrine of quantum meruit. In Count II, AT&T contends that the RDA contract was awarded as a fixed-price development contract in violation of law and regulation as a result of the parties' mutual mistake of fact. AT&T seeks to have the contract reformed to a cost-type contract to correct the parties' mistake. At present, AT&T brings before the court for consideration only that part of Count I which challenges the legality of the RDA contract on grounds of non-compliance with section 8118.

DISCUSSION

Defendant's Motion to Dismiss

Defendant contends that this case must be dismissed for lack of jurisdiction. There are two branches to the argument. The first, which we take up immediately below, goes to the question whether the court has before it a "claim" within the meaning of the Contract Disputes Act, 41 U.S.C. §§ 601-613 (1988 & Supp. V 1993); the second has to do with AT&T's request for relief on a quantum meruit basis. The latter part we leave to the discussion on the merits.

We begin then with the argument centered on the Contract Disputes Act. Defendant maintains that the demand presented by AT&T fails to satisfy judicially-defined standards for the existence of a claim under the Contract Disputes Act and therefore cannot be heard by this court. According to defendant, the requisites of a claim - as defined either for purposes of this court's jurisdiction or for purposes of a contracting officer's final decision authority - demand, first of all, the existence of a dispute between the contracting parties. That is to say, the subject of the contractor's request for relief - the contract entitlement that is being claimed - must have evolved to the point of impasse between the parties. Absent the existence of a dispute, a contractor's written submission of a demand for relief cannot be considered the submission of a claim.

Additionally, defendant maintains that where the relief that is sought is the payment of money (the case here), the dispute between the parties must extend to and include a sum certain. Thus, allegations of entitlement, unaccompanied by the demand for a specific sum, are, in defendant's view, insufficient to establish a claim for money.

It is upon this last-stated proposition - the alleged necessity for a dispute centered on a sum certain - that defendant bases its motion to dismiss. Defendant points out that AT&T did not state the amount of its claim with any specificity until the submission of its certified claim on December 18, 1992. Up to that point, the dialogue that had taken place between the parties was confined to AT&T's theories of recovery as opposed to the amount of that recovery. Consequently, the dispute that emerged never focused on a specific sum. And that limitation, defendant now maintains, rendered the contractor's written submission of December 18, 1992 inadequate for purposes of obtaining a contacting officer's final decision on a money claim. In substantiation of this argument, defendant refers the court to

a number of Federal Circuit decisions, chief among these being the decision in Dawco Construction, Inc. v. United States, 930 F.2d 872 (Fed. Cir. 1991).

That case, in our view, does not stand for the proposition for which it is now being cited. Granted, the court there did say that "a claim must seek payment of a sum certain as to which a dispute exists at the time of submission." 930 F.2d at 878. These words, however, may not be read in isolation. Rather, they are to be understood in the context of the problem that occasioned them. Specifically, the contractor there had requested a contracting officer's final decision on a proposal for an equitable adjustment (addressing Government-acknowledged changes) that set forth costs that were incomplete and that had not been previously discussed between the parties. It was in that specific setting that the court declared that a "claim" demands a request for payment that is in dispute. But, in so speaking, all the court was doing was noting the obvious: that it made no sense to label an asserted entitlement a claim when the party against whom the demand was being made had had no meaningful opportunity to evaluate its merits. A claim, in other words, does not arise until it is known whether the entitlement that is asserted will, in fact, be contested.

Moreover, that contest does not have to reach the specific amount in issue in order to transform a disagreement into a claim. A disagreement on the threshold issue of liability is as much a claim for purposes of the CDA as a disagreement on the amount of entitlement. This point is made clear by the text of the governing regulation, 48 C.F.R. § 33.201 (1994):

> Claim, as used in this subpart, means a written demand or written assertion by one of the contracting parties seeking, as a

> matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to the contract. . . . A voucher, invoice, or other routine request for payment that is not in dispute when submitted is not a claim. The submission may be converted to a claim, by written notice to the contracting officer as provided in 33.206(a), if it is disputed either as to liability or amount or is not acted upon in a reasonable time. (second emphasis added).

Given this regulation, there is no room for the argument that a demand for monetary relief under a contract cannot be considered a claim for purposes of the Contract Disputes Act unless and until both liability and amount have been put into issue. The regulation plainly recognizes that a written demand seeking payment of a sum certain becomes a claim "if it is disputed either as to liability or amount." Indeed, where liability is disputed, it necessarily follows that "amount" is also.

To sum up, given our reading of Dawco as well as the straightforward text of the procurement regulation, this court can find no basis upon which to sustain the Government's argument. Accordingly, we reject the contention that a demand for monetary relief cannot be elevated to a claim absent an antecedent dispute that specifically took into consideration the amount of that demand. The court therefore holds that AT&T's submission of December 18, 1992 constituted a claim for purposes of the Contract Disputes Act. Thus, we have jurisdiction over this matter.

The Motions for Summary Judgment

As earlier noted, AT&T is asking for reformation of its contract to a cost-reimbursement, incentive-fee contract or, in the alternative, for a declaration holding the contract void with payment for benefits conferred to be allowed on a quantum meruit basis. The premise for each of these demands is AT&T's contention that award of the RDA contract should have proceeded in accordance with the requirements of section 8118. That it did not so proceed, plaintiff contends, renders the contract illegal and thus subject either to reformation or annulment.

These arguments are met by the defendant with a number of contentions starting with the proposition that plaintiff lacks standing to contest the Government's administration of section 8118. That statute, defendant maintains, was enacted for the Government's own benefit and protection and not for the benefit of defense contractors. Consequently, whatever shortcomings might exist in regard to the Navy's implementation of section 8118, continues the argument, they abridge no enforceable rights of the plaintiff and thus offer no basis for suit in this court.

In deciding the merits of this argument we look to the words of section 8118. Among other things, the statute calls upon the Secretary of Defense to provide the congressional appropriations committees with quarterly reports identifying funding obligations committed to fixed-price type developmental efforts. Certainly, in this aspect, the statute is consistent with defendant's position that section 8118 was essentially a housekeeping provision focused on the Government's own needs. The aim of this reporting requirement was obviously to facilitate congressional oversight.

However, the focus of section 8118 is not restricted just to the reporting of fixed-price contracts for purpose of facilitating legislative budgetary controls. No less a concern of the statute -- indeed, one could say, its principal concern - is to confine the use of fixed-price development contracts to situations where a determination has been made in writing "that program risk has been reduced to the extent that realistic pricing can occur." The purpose of this requirement, as the statute itself declares, is to insure "an equitable and sensible allocation of program risk between the contracting parties."

Quite plainly, then, the statute has more than the Government's own interests in mind. As plaintiff points out, use of the words "risk," "equitable," "sensible," "allocation," and "contracting parties" reflects a concern for sound contracting policies that encompasses the interests of both parties -- contractors as well as the Government. Thus, by the plain words of the statute, the court is bound to conclude that section 8118's requirement for a written determination upholding the pricing integrity of a fixed-price development contract operates as a constraint on the contracting process intended for the protection of both Government and contractor. Accordingly, the failure to fulfill that requirement presents an issue of contract validity (a point we take up later) that either party has standing to raise.

Moving on, the Government next contends that even if plaintiff has standing to raise a section 8118 issue, no violation of law presents itself here because the RDA contract was not subject to the requirements of that section. Consideration of this argument takes us to the definition that was given by the Department of Defense to the phrase "major system" that appears in section 8118.

On February 11, 1988, two months after the enactment of section 8118, the Under Secretary of Defense

for Acquisition issued a memorandum containing guidance for the implementation of that section. This memorandum instructed that, for purposes of section 8118, a major system was to be given the same definition as applied to that term in 10 U.S.C. § 2302(5). That section reads in relevant part as follows:

> The term "major system" means a combination of elements that will function together to produce the capabilities required to fulfill a mission need. The elements may include hardware, equipment, software or any combination thereof, but excludes construction or other improvements to real property. A system shall be considered a major system if (A) the Department of Defense is responsible for the system and the total expenditures for research, development, test, and evaluation for the system are estimated to be more that $75,000,000 (based on fiscal year 1980 constant dollars) or the eventual total expenditure for procurement of more than $300,000,000 (based on fiscal year 1980 constant dollars)...[.]

The directive set out in the Under Secretary's memorandum of February 11, 1988, was later incorporated into a formal instruction of the Secretary of the Navy, SECNAV Instruction 4210.6A, issued April 13, 1988. Thus, within roughly four months of the award of the RDA contact, the Navy had in place a guideline for application of section 8118 that defined a major system as one for which total expenditures, expressed in fiscal year 1980 dollars, were estimated to be more than 75 million dollars for research and development effort or more than 300 million dollars in production-item costs.

It is to this definition that defendant now points in support of its contention that section 8118 does not apply here. Starting with the proposition that the RDA contract involved the development of a system, as opposed to a subsystem, defendant goes on to point out that the contract contemplated a total expenditure for research and development effort of less than 75 million dollars; hence, it is argued that section 8118 has no application.

Plaintiff disagrees with these assertions. Plaintiff notes, first of all, that the RDA contract, as well as the Space and Naval Warfare Systems Command's published guide to the operational procedures of the SURTASS system, refer to the reduced diameter array as a subsystem rather than as a system. These descriptions, plaintiff further points out, are consistent with the definition of subsystem which was adopted by another military service branch, the Air Force, for purposes of implementing section 8118. That Service's published guidance for section 8118 describes subsystems as "the key elements of the major systems that function together to produce the system's capabilities required to fulfill a mission need." Thus, the reduced diameter array, plaintiff maintains, is properly classified as a major element of the Surveillance Towed-Array Sensor System (SURTASS); hence, a subsystem. In plaintiff's view then, since the RDA contract involved a subsystem rather than a major system, the definition defendant relies upon to avoid the application of section 8118 has, in fact, no bearing on the issue. Rather, what controls here is the $10,000,000 threshold spelled out in section 8118.

Taking the response a step further, plaintiff also contends that even if the reduced diameter array could be considered a major system rather than a subsystem, it would not escape the requirements of section 8118. To be more specific, plaintiff contends that the definition defendant relies upon -- which puts the threshold for the application of

section 8118 to research and development contracts at $75,000,000 -- is inconsistent with the corresponding figure set out in section 8118, namely $10,000,000. Thus, plaintiff argues that defendant's definition, being in conflict with the words of the statute, must be judged erroneous as a matter of law and thus of no force or effect.

In resolving this particular dispute, we put aside the question whether the reduced diameter array is more properly regarded as a subsystem than a system. It is enough for us to note that even if we accept defendant's contention that the reduced diameter array is a system in and of itself, rather than a subsystem of SURTASS, we cannot subscribe to the remainder of defendant's argument. Like plaintiff, this court too sees an unacceptable antagonism between the command of section 8118 and the attempted implementation of that command through the application of 10 U.S.C. § 2302(5).

Section 8118 says that appropriated funds may not be obligated or expended "for fixed price-type contracts in excess of $10,000,000 for the development of a major system" absent a written determination of pricing validity. Obviously, from Congress' point of view, major system expenditures begin at $10,000,000. Not so, however, under the definition of major system adopted by the Department of Defense. Going by that definition, a system is recognized as a major system only where Department of Defense expenditures "for research, development, test, and evaluation . . . are estimated to be more than $75,000,000." 10 U.S.C. § 2302(5).

Clearly there is an incompatibility here. Adherence to the Department of Defense's definition of major system results in excluding from the purview of section 8118 all expenditures for fixed-price research and development effort on major systems that fall below the $75,000,000 marker.

Thus, the application of section 8118 is significantly narrowed. Defendant maintains, however, that since section 8118 itself provides no definition for the term "major system," the definition adopted by the agency charged with the administration of the statute is controlling. In support of this proposition, we are referred to the decision in Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984).

We reject defendant's argument. Granted, deference is owed to an agency's interpretation of a statute it is charged with administering. But deference, the Supreme Court has pointed out, "is not abdication, and it requires . . . [courts] to accept only those agency interpretations that are reasonable in light of the principles of construction courts normally employ." EEOC v. Arabian American Oil Co., 499 U.S. 244, 260 (1991) (Scalia, J., concurring). First among these principles of construction is that the meaning of a statute is to be taken from the words it employs and where those words are clear and unambiguous, the task of statutory interpretation is at an end - the plain meaning of the words controls. See Chevron, 467 U.S. at 842-43 ("If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." (footnote omitted)).

In this case, Congress has enacted a statute directed to the prospective award of "fixed price-type contracts in excess of $10,000,000 for the development of a major system or subsystem." The agency, in turn, has adopted as its guideline for the enforcement of this statute a definition that renders the statute inoperative with respect to those contracts which, while otherwise within the statute's reach, involve expenditures of less than $75,000,000. Such an administrative action cannot be upheld. It amounts not to interpretation of a statute but to the rewriting of a statute.

Nor can this interpretation be redeemed by contending, as defendant also does, that the incorporation of section 8118 into subsequent appropriation statutes, without any change in its text, is to be taken as a signal of Congress' approval of that interpretation. There are two answers to this contention. First, nothing in the record would permit us to say that Congress was ever made aware of the precise manner in which section 8118 was applied by the Department of Defense. True, the statute contained a requirement directing the Under Secretary of Defense to advise the congressional appropriations committees, on a quarterly basis, of all contracts for research and development awarded on a fixed-price basis. But all Congress reasonably could be expected to glean from such a reporting requirement is the dollar amount of fixed-price research and development contracts; not the statutory interpretation that governed the contract listing in the first instance.

Second, even if one could expect Congress to have become aware of the Department of Defense's definition for major system under section 8118, there is still no basis here for according that definition any legal effect. The rule that congressional reenactment of a statute may be taken as approval of the administrative construction applied to it cannot be invoked to engraft upon the statute a meaning hostile to its plain words. "When a regulation conflicts with the statute, the fact of subsequent re-enactment 'is immaterial, for Congress could not add to or expand [the] statute by impliedly approving the regulation.' " Leary v. United States, 395 U.S. 6, 25 (1969) (footnote omitted) (quoting Commissioner v. Acker, 361 U.S. 87, 93 (1959)). The action taken by the Department of Defense is contrary to

the clearly expressed intent of Congress and is therefore contrary to law.[1]

But what is the consequence of this determination as far as the RDA contract is concerned? According to defendant, very little. Says defendant: "It is plain on the face of Section 8118 that a violation [of that section] represents an illegality not in the award of the RDA contract but merely in its funding." And in further explanation of this position, defendant adds: "[a]ll that was allegedly improper was the use of FY 1988 funding, which, if deemed inappropriate, could be remedied by a routine funding adjustment . . . rather than by declaring the contract void or unenforceable." To round out the argument, defendant points out that "FY 1987 R&D funds were legally available for obligation at the time the contract was awarded."

The court cannot accept this reasoning. Under the terms of section 8118, appropriated funds could not be "obligated or expended" for fixed price research and development contracts involving major systems and subsystems absent a written determination supporting the credibility, from a research and engineering standpoint, of the parties' risk assessment and the resulting soundness of their contract pricing. Funds are considered obligated, that is, an amount is recorded as an obligation of the United States, upon the execution of a binding agreement between an agency and another person before the end of the period during which the appropriation remains available. 31 U.S.C. § 1501 (1988). Thus, the authority to obligate funds is synonymous with the authority to contract. It follows, therefore, that absent compliance with the written

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[1] As pointed out in the Chevron decision, "[t]he judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent." 467 U.S. at 843 n.9.

determination requirement of Section 8118, no authority to obligate funds came into being and thus no valid contract was created.

The constraint imposed on the expenditure of appropriated funds by section 8118, is indistinguishable, in principle, from a specific dollar limitation imposed by a statute authorizing expenditures for a particular project. In such cases too the failure to observe the conditions imposed on the obligation and expenditure of appropriated funds results in a contract void for lack of authority. Curtis v. United States, 2 Ct. Cl. 144, 151-52 (1866). The impairment present here is not curable through a retroactive funding adjustment. Nor, for that matter, is it a defect that can be overcome by waiver or remedied by ratification. "[A] clear showing of illegality in an award precludes any contract from arising." Alabama Rural Fire Ins. Co. v. United States, 215 Ct. Cl. 442, 454, 572 F.2d 727, 733 (1978). In the eyes of the law, no formal contract was ever created.

We come, finally, to the basic assertions on which this suit is founded. Plaintiff maintains that the Navy's failure to adhere to the requirements of section 8118 in connection with the award of the RDA contract has resulted in the very harm the statute was intended to overcome, namely, the disproportionate allocation of pricing risk upon the contractor. Had the Under Secretary of Defense for Acquisition or his delegate complied with the statute, plaintiff maintains, the risks inherent in the work would have become apparent and a cost-type reimbursement contract with a fixed fee would have resulted. Therefore, to now achieve that result -- to bring about what, according to plaintiff, should have been the case from the start -- the court is asked to reform the RDA contract to a cost-type, fixed-fee arrangement and to redistribute the accumulated contract costs accordingly.

As an alternative to the request for contract reformation, plaintiff asks that the contract be declared a nullity and that, in its place, we recognize the existence of an implied-in-fact contract with compensation to be measured on a quantum meruit basis.

To speak first to reformation, this is a contract remedy which courts may grant in order to conform the parties' written agreement with their antecedent intent, that is, with the agreement that actually was reached. Thus, reformation, for the most part, is concerned with mistakes in expression, as in the case of the omission of an agreed-upon term, or the inclusion of a term not agreed upon or the incorrect reduction of a term to writing. E. Allan Farnsworth, Contracts § 7.5, at 468 (1982).

Reformation has also been invoked to rid a contract of a provision that contravenes existing law. See, for example, Beta Systems, Inc. v. United States, 838 F.2d 1179, 1186 (Fed. Cir. 1988) (recognizing reformation as appropriate means for correcting contract's incorporation of an economic price adjustment index not sanctioned by Government procurement regulations); Chris Berg, Inc. v. United States, 192 Ct. Cl. 176, 183, 426 F.2d 314, 318 (1970) (granting reformation to allow upward adjustment in contract price to redress bid error whose correction, though authorized by regulation, the contracting officer had improperly refused), and Nautilus Shipping Corp. v. United States, 141 Ct. Cl. 391, 395, 158 F. Supp. 353, 355 (1958) (directing downward adjustment in agreed-upon purchase price of surplus vessel to conform to statutory pricing formula). The cited cases are among those upon which plaintiff relies for the proposition that where a contract is illegal it may be rewritten by the court so as to conform to what the parties would have negotiated had they complied with the law. It is this reasoning which leads plaintiff to the

conclusion that the court may now reform the RDA to make of it a cost-reimbursement, fixed-fee undertaking.

There is no authority in this court to bring about the result plaintiff seeks. With respect to a court's power to order reformation, there is a critical difference between an otherwise valid contract that contains a prohibited term or clause and a contract that is void from the inception. The former is amenable to reformation on the theory that the offensive provision is not significant enough to undermine the foundations of the contract; hence, to preserve the parties' contract, the court undertakes to correct what the parties could be expected to remedy on their own if the illegality were pointed out. Reformation of this limited character is simply an elaboration upon the parties' intent; see, as an example, Beta Systems, Inc. v. United States, 838 F.2d 1179, 1186 (Fed. Cir. 1988); it is akin to the power exercised by a court when supplying a missing term to an agreement otherwise sufficiently specific to be enforceable.

But reformation of the sort plaintiff proposes is a much different matter. The RDA contract, being void from the inception, cannot be reformed. Said otherwise, there is no power to remake that which was never established in the first instance. This same result obtained in Hedges v. Dixon County, 150 U.S. 182 (1893). In that case, holders of bonds that a municipality had issued for amounts exceeding its borrowing authority, sought reformation of their instruments so as to conform them to the legal limits and thus to render the bonds enforceable to that extent. The Court held the invalidity of the bonds precluded their reformation:

> Where a contract is void at law for want of power to make it, a court of equity has no jurisdiction to enforce such contract, or, in the absence of fraud, accident, or mistake to

> so modify it as to make it legal and then enforce it.

150 U.S. at 192. This too is a case where reformation cannot be had.

The last matter we address is plaintiffs demand that the RDA contract be declared a nullity, and that in its place, we recognize the existence of an implied-in-fact contract with compensation to be awarded on a quantum meruit basis. Defendant objects to this demand saying that relief granted for benefits conferred under a contract later declared void cannot be rationalized on an implied-in-fact contract basis. Rather, defendant contends, any relief the court may afford under such circumstances is, in reality, relief granted under a contract implied-in-law, i.e., an unjust enrichment principle, and, as such, falls outside this court's authority under the Tucker Act, 28 U.S.C § 1491 (1988 & Supp. V 1993). Therefore, defendant moves for dismissal of this branch of plaintiff's case for lack of jurisdiction..

Although this court recognizes the analytical force of defendant's argument, the issue is not one upon which discussion can profitably proceed. The question was squarely answered against defendant in United States v. Amdahl Corp., 786 F.2d 387 (Fed. Cir. 1986). In that case, the court of appeals discussed, at length, the rule that where goods or services have been provided to the Government under a contract subsequently declared invalid, the contractor is entitled to recovery upon an implied contract for quantum meruit or quantum valebant.[2] The court of

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[2] Quantum meruit, which translates "as much as he deserved," and quantum valebant, which translates "as much as they were worth," refer to the measures of recovery that are allowed a plaintiff for benefits provided a defendant under a contract lacking a price term or under circumstances

appeals specifically referred to the implied contract as an implied-in-fact contract. Here is what the court wrote:

> [I]n many circumstances it would violate good conscience to impose upon the contractor all economic loss from having entered an illegal contract. Where a benefit has been conferred by the contractor on the government in the form of goods or services, which it accepted, a contractor may recover at least on a quantum valebant or quantum meruit basis for the value of the conforming goods or services received by the government prior to the rescission of the contract for invalidity. The contractor is not compensated under the contract, but rather under an implied-in-fact contract.

786 F.2d at 393. In light of the foregoing, we deny defendant's motion to dismiss for lack of jurisdiction plaintiff's demand for relief measured on a quantum meruit basis.

The question remains, however, whether plaintiff is entitled to such relief. The rule requiring the Government to pay for the value of any tangible benefits received under a contract later deemed void is a restitutionary principle the object of which is to restore the parties to the position they held before the contract was awarded. To the extent altered circumstances preclude restitution in kind, for example, where services have been performed or goods delivered and

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where fairness demands that compensation be granted. Dan B. Dobbs, Remedies § 4.2, at 237-38 (1973). Quantum meruit applies where the benefits provided are in the form of services; quantum valebant where they are in the form of goods.

sold, then an award of money becomes the substitute, the amount being determined on the basis of value to the recipient. The conceptual underpinning for a restitutionary measure of recovery is the avoidance of unjust enrichment. Dan B. Dobbs, Remedies § 4.1, at 224 (1973); Restatement (Second) of Contracts § 344 cmt. a (1979). As the decision in Amdahl put it: "it would violate good conscience to impose upon the contractor all economic loss from having entered an illegal contract." 786 F.2d at 393.

It is with the last-mentioned point -- the recognition that restitution is aimed at avoiding unjust enrichment -- that plaintiff's position encounters difficulties. In the name of quantum meruit, we are asked to reconstitute an invalid losing contract into an enforceable and profitable one. Indeed, what plaintiff seeks from this court is not the avoidance of some economic loss associated with its contract performance but, rather, the avoidance of all economic loss. Perhaps, in a proper case, such relief would be warranted, for as one commentator has observed, "[i]f there is any one rational principle that might be used to guide restitutionary measurements it is that the measure of restitution should reflect the substantive law purposes that call for restitution in the first place." Dan B. Dobbs, Remedies § 4.5, at 260 (1973).[3]

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[3] The court is aware that restitution is not an available remedy where completed performance has occurred and nothing remains to be done save payment of the contract price. In that circumstance, recovery is limited to the price. See Restatement (Second) of Contracts § 373(2) and cents. a, d (1979). However, we see this limitation as being applicable only to situations where restitution is being sought as an alternative to contract enforcement, i.e., as a remedy for breach.. Conceptually, the limitation should have no application in determining the measure of recovery

The question, however, is whether this is such a case; there is much that needs to be answered. The central concern, of course, is whether the relief being sought is warranted on the facts. Would the failure to grant relief to AT&T "unjustly" enrich the defendant? To answer that ultimate question, the court needs answers to the following preliminary questions:

1. At what point in the procurement history of the RDA contract did AT&T become aware of section 8118?

2. What factors account for the cost overrun that AT&T experienced in its performance of the RDA contract?

3. To what extent would the factors identified in answer to question 2 have been amenable to relief through claims for equitable adjustment?

4. The record indicates that award of the RDA contract to AT&T was contested by a disappointed bidder who challenged AT&T's offer as a "buy-in." What factors were cited in support of this allegation? What was AT&T's response to this allegation?

5. At the time of award of the RDA contract, could satisfaction of the Navy's need for an undersea surveillance system have been achieved through the purchase of some other type of system? If so, at what cost?

6. How is the value of the benefit conferred on the Government by the RDA contract to be measured?

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appropriate to contracts void from their inception. In the latter situation, the objective is restoration of the parties to their pre-contract status.

CONCLUSION

For the reasons stated in this opinion, the court denies defendant's motion to dismiss for lack of jurisdiction and defendant's motion for summary judgment.[4] Also denied is plaintiff's cross-motion for partial summary judgment.

The issue left open by the court's opinion -- whether plaintiff is entitled to recovery on a quantum meruit basis for the value of the benefits conferred upon the Government under the RDA contract -- will require factual supplementation of the record either by stipulation of the parties or through trial.

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[4] Although plaintiff has not formally opposed that part of defendant's motion directed to Count II of the complaint (the mutual mistake allegation), we nevertheless deny that part also. We do so because factual inquiry is still open (in accordance with the present opinion); hence, plaintiff may adduce facts which, though offered in support of Count I, would also have legal significance in respect to Count II. Counts I and II are not so dissimilar in their legal elements as to rule out the possibility of overlapping facts in their proofs.

(5)

Supreme Court, U.S.
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No. 02-1569

In the Supreme Court of the United States

AMERICAN TELEPHONE AND TELEGRAPH COMPANY AND LUCENT TECHNOLOGIES INC., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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18 pp

QUESTIONS PRESENTED

Section 8118 of the Department of Defense Appropriations Act for Fiscal Year 1988 placed conditions on the use of appropriated funds for fixed-price development contracts. Petitioners successfully bid for and performed a fixed-price development contract that did not meet the conditions imposed by Section 8118. The questions presented are:

1. Whether petitioners are entitled to convert the completed contract from a fixed-price contract to a cost-reimbursement contract.

2. Whether petitioners waived their asserted right to be reimbursed on the basis of cost by failing to seek cost-based reimbursement before performance of the contract began.

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-18a) is reported at 307 F.3d 1374. The opinion of the Court of Federal Claims (Pet. App. 21a-32a) is reported at 48 Fed. Cl. 156. The prior en banc opinion of the Federal Circuit (Pet. App. 33a-72a) is reported at 177 F.3d 1368.

JURISDICTION

The judgment of the court of appeals was entered on October 8, 2002. A petition for rehearing was denied on January 27, 2003 (Pet. App. 19a-20a). The petition for a writ of certiorari was filed on April 25, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. On December 22, 1987, Congress enacted an Act appropriating funds for the Department of Defense (DOD) for Fiscal Year 1988. Pub. L. No. 100-202, 101 Stat. 1329-1. Section 8118 of the Act provided that appropriated funds could not be obligated or expended for major fixed-price development contracts unless the Under Secretary of Defense for Acquisition made a written determination "that program risk has been reduced to the extent that realistic pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties." 101 Stat. 1329-84. Section 8118 further required DOD quarterly to report to Congress all fixed-price contract awards made under the provision. *Ibid.*

On December 31, 1987, just nine days after Congress enacted Section 8118, the Navy awarded a fixed-price incentive contract to petitioner American Telephone and Telegraph Company (AT&T) for the development of a new anti-submarine sonar system. DOD did not previously make the determination specified in Section 8118. Although the Navy determined AT&T's proposal to be technically inferior to that of a competitor, the Navy awarded the contract to AT&T based upon the significantly reduced price offered by AT&T in the final days of negotiation. A competitor subsequently protested the contract award, asserting, *inter alia*, that AT&T's price was erroneous. *Gould, Inc. Ocean Sys. Div.*, B-229965, 88-1 CPD § 457 (May 16, 1988). AT&T defended the award, asserting in part that it understood the risks of the contract and that the pricing was accurate. Pet. App. 4a. At no time during the solicitation, contract award, or subsequent bid protest, did

AT&T ever object to the contract being awarded on a fixed-price basis or assert that it was entitled to a cost-reimbursement type contract. *Id.* at 11a-12a, 31a, 47a. AT&T likewise never requested the Navy to make the determination specified in Section 8118.

AT&T performed the contract at a cost of $91 million, well in excess of the final adjusted contract price of approximately $34.5 million. In 1992, five years after performance of the contract began, AT&T filed a claim with the contracting officer asserting that the contract was invalid based upon the government's failure to comply with Section 8118. After the contracting officer denied the claim, AT&T filed suit in the Court of Federal Claims. AT&T alleged that, as a result of the government's failure to comply with Section 8118, AT&T was not bound by the fixed-price terms of the contract and was instead entitled to reformation of the contract to a cost-reimbursement contract or a recovery of their costs and a reasonable profit under equitable principles of *quantum meruit.*

2. The trial court held that the failure to comply with Section 8118 rendered the entire contract void *ab initio* and might support a *quantum meruit* claim, and certified its ruling for interlocutory appeal. Pet. App. 120a-135a. A divided panel of the Federal Circuit affirmed in part and reversed in part, holding that the contract was void but concluding that *quantum meruit* relief was not available. *Id.* at 75a-103a. Judge Newman dissented from the majority's finding that the contract was void. *Id.* at 97a-103a.

A divided en banc court of appeals held that Section 8118 provided no basis for declaring the contract void *ab initio.* Pet. App. 33a-72a. The court found that Section 8118 imposed only "internal," "supervisory," "oversight" requirements and that Congress specifi-

cally intended to monitor and enforce compliance with Section 8118 through its own oversight powers. *Id.* at 44a-46a. The court also noted that the Federal Circuit's precedents disfavor the invalidation of a contract on the ground of illegality after the contract has been fully performed. *Id.* at 46a-49a. The court therefore remanded the case to the trial court so that AT&T could present "such claims [for relief], if any, that it may have." *Id.* at 49a-50a.

Judges Rader, Mayer, and Lourie concurred, reasoning that Section 8118 did not apply to the contract. Pet. App. 51a-54a.

Judge Plager dissented in part and concurred in part. Pet. App. 55a-72a. In his view, the Navy's violation of Section 8118 rendered the contract void, *id.* at 55a-66a, but AT&T's demand for additional money was "facially nonsensical." *Id.* at 67a. As Judge Plager explained:

> AT&T comes to the court with unclean hands. AT&T is not an innocent bystander being taken advantage of by a predator government. Both the Government and AT&T knew exactly what they were doing when they entered into this deal. It simply defies belief that AT&T was unaware of § 8118 when it purported to contract with the Government or was unaware that the Navy was proceeding with the contract in the manner the Navy did.

Id. at 68a-69a.

On remand, the trial court held that AT&T was not entitled to reformation of the contract. Pet. App. 32a. The trial court concluded that "[t]he same reasoning that led the court of appeals to reject the argument that the RDA contract was void from the start now leads us to say that the contract is enforceable as it stands." *Id.*

at 30a. The court explained that "non-compliance with the statute is not an actionable wrong," and that contractors "cannot claim a protectable interest in the proper application of Section 8118 for Congress intended to give them none." *Ibid.*

3. A divided panel of the Federal Circuit affirmed. Pet. App. 1a-14a. The court of appeals held Section 8118 provides no basis for awarding judicial relief to petitioners. The court reasoned that Section 8118 "is an appropriations oversight provision that envisions enforcement, if any, in the form of legislative spending adjustments in future bills." *Id.* at 7a. The court thus concluded that "Section 8118 simply does not provide implicitly or explicitly for any enforcement of its supervisory and congressional oversight provisions in a judicial forum." *Id.* at 9a.[1]

The court further held that "[i]n view of the facts of this case, [the] court would be forced to conclude that AT&T waived its present arguments even were those arguments to state a valid claim." Pet. App. 11a. The court reasoned that, "[d]espite AT&T's sophistication on these matters," AT&T presented no evidence that it ever sought a cost-reimbursement contract during the contract negotiations. *Id.* at 11a-12a. Under those circumstances, the court held that "the proper time for AT&T to have raised the issues that it now presents was at the time of contract negotiation, when effective remedy was available." *Id.* at 13a.

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[1] The court also affirmed the trial court's rejection of petitioners' contentions that it was entitled to relief based on the Navy's alleged violation of its procurement regulations and directives. Pet. App. 9a-11a. Petitioners do not challenge that holding in this Court.

Judge Newman dissented. Pet. App. 15a-18a. She stated that she did "not know whether this contract warrants relief" but that "[t]he briefs raise factual and legal questions, and equitable aspects, the weight and value of which have never been aired." *Id.* at 18a. Judge Newman stated, however, that she was not "suggest[ing] that government procurement contracts are readily subject to change after performance," since "[t]he law and precedent of contract and procurement require some grave error or mutual mistake or changed circumstances, such as would render it unconscionable for the government to require performance of the original terms." *Id.* at 18a n.2.

ARGUMENT

1. AT&T and its successor in interest, Lucent Technologies, Inc., argue (Pet. 13-27) that they are entitled to recover over $55 million in losses that AT&T sustained in performing the contract at the fixed price, based on the DOD's failure to determine that the contract involved a fair allocation of risk as required by Section 8118. The court of appeals correctly rejected that proposition. Section 8118 bars the expenditure or obligation of DOD appropriated funds for certain "fixed price-type contracts" for the development of a major system or subsystem unless a specified DOD official determines in writing "that program risk has been reduced to the extent that realistic pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties." § 8118, 101 Stat. 1329-84. The statute also requires the DOD to report to the relevant appropriation committees on a quarterly basis "the contracts which have obligated funds under such a fixed price-type developmental contract." *Ibid.*

There is nothing in the text of Section 8118 that suggests that a contract awarded in violation of the provision is invalid or that the contractor is relieved from the terms of a fully performed contract. As the court of appeals explained, "[t]he language of [S]ection 8118 does not explicitly create a cause of action for enforcement of its expenditure prohibitions." Pet. App. 6a. Rather, Section 8118 "envisions enforcement, if any, through legislative procedures." *Ibid.*

The absence of any right of action to enforce Section 8118 is confirmed by subsequent congressional developments. By its terms, Section 8118 applied only to funds appropriated for Fiscal Year 1988. Four months later, as part of the DOD authorization and appropriations process for Fiscal Year 1989, Congress considered and eventually enacted funding restrictions similar to Section 8118. The Senate Armed Services Committee, addressing a draft successor provision to Section 8118, stated, "[i]t is the intent of the committee that this section be applied in a manner that best serves the government's interests in the long term health of the defense industry, and *that this section not be used as the basis for litigating the propriety of an otherwise valid contract.*" S. Rep. No. 326, 100th Cong., 2d Sess. 105 (1988) (emphasis added). Indeed, rather than providing for a right of action, Congress for Fiscal Years 1990 through 1993 elected to enforce the funding restriction embodied in Section 8118 by instructing the DOD to issue pre-award quarterly reports. Act of Nov. 21, 1989, Pub. L. No. 101-165, § 9048, 103 Stat. 1139; Act of Nov. 5, 1990, Pub. L. No 101-511, § 8038, 104 Stat. 1882; Act of Nov. 26, 1991, Pub. L. No. 102-172, § 8037, 105 Stat. 1179-80; Act of Oct. 6, 1992, Pub. L. No. 102-396, § 9037, 106 Stat. 1910.

For those reasons, petitioners err in asserting (Pet. 18) that the court of appeals' decision "appears to create a *broad, new principle*" that violations of procurement statutes and regulations may not support judicial relief in the absence of an *explicit* right of action. Based on the particular statutory language, structure, and history of the funding restriction in Section 8118, the court of appeals concluded that "Section 8118 simply does not provide *implicitly* or explicitly for any enforcement of its supervisory and congressional oversight provisions in a judicial forum." Pet. App. 9a (emphasis added).[2] That ruling is entirely consistent with the settled principle that a contract that the government unlawfully entered into does not automatically entitle the contractor to judicial relief. *E. Walters & Co.* v. *United States*, 576 F.2d 362, 367 (Ct. Cl. 1978). Thus, "[w]hen a contract or a provision thereof is in violation of law but has been fully performed, the courts have variously *sustained the contract*, reformed it to correct the illegal term, or allowed recovery under an implied contract theory." Pet. App. 16a (quoting *AT&T* v. *United States*, 177 F.3d 1368, 1376 (Fed. Cir. 1999) (en banc)) (emphasis added). Accordingly, courts routinely enforce government contracts even though the government has violated statutes or regulations relating to the procurement or award process. *E.g.*, *United States* v. *New York & Porto Rico S.S. Co.*, 239 U.S. 88, 92-93

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[2] Petitioners mistakenly assert (Pet. i, 2-3, 5-6, 9-10, 13, 21) that Congress enacted Section 8118 for the benefit of private defense contractors. The conference report that accompanied Section 8118 explains that the statute's primary purpose was to avoid unnecessary costs associated with the renegotiation of fixed-price contracts and to maintain congressional appropriations oversight authority. H.R. Conf. Rep. No. 498, 100th Cong., 1st Sess. 623-624 (1987).

(1915) (contract made in violation of the statute of frauds is enforceable); *Cessna Aircraft Co.* v. *Dalton*, 126 F.3d 1442, 1446, 1451-1452, 1454-1455 (Fed. Cir. 1997) (rejecting allegation that option contract was unenforceable due to alleged violation of the Anti-Deficiency Act and related funding regulations), cert. denied, 525 U.S. 818 (1998); *Whittaker Elec. Sys.* v. *Dalton*, 124 F.3d 1443, 1445-1446 (Fed. Cir. 1997) (rejecting allegation that option contract unenforceable as a violation of various procurement regulations, including one addressing "undue risks" in multi-year contracts); *LaBarge Prods., Inc.* v. *West*, 46 F.3d 1547, 1552-1556 (Fed. Cir. 1995) (contract enforceable despite violation of procurement regulations).

We are aware of no appellate decision (and petitioners cite none) that awards a contractor relief upon a fully performed contract on the theory that the government violated a funding restriction in an appropriations bill. Indeed, despite the multitude of opinions by the members of the Federal Circuit in this case, not one appellate judge has expressed the view that petitioners are entitled to any relief in this case.

2. There is no basis for petitioners' contentions (Pet. 1, 3, 13-17, 27) that the court of appeals' decision will adversely affect defense procurements. It is neither remarkable nor novel to hold contracting parties to the terms of their contract. *Madigan* v. *Hobin Lumber Co.*, 986 F.2d 1401, 1403 (Fed. Cir. 1993) ("A long line of our precedent has established that agreed-upon contract terms must be enforced."). This principle applies equally when the Government is a party to the contract. *General Bronze Corp.* v. *United States*, 338 F.2d 117, 124 (Cl. Ct. 1964) ("If the government is to be held strictly to its contractual obligations as though it were a private obligor, then, of course, it is entitled to insist

that those who contract with it shall be held to the same accountability.").

Petitioners also err in suggesting that the court of appeals' decision gives DOD "free reign to violate, whenever in its economic interests to do so," funding restrictions like those embodied in Section 8118. Pet. 15. That contention ignores both the ample tools available to Congress to ensure compliance with limits imposed on agencies during the appropriations process and the Anti-Deficiency Act. That Act makes it unlawful for federal officers to "make or authorize an[y] expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation." 31 U.S.C. 1341(a)(1)(A). Violators of the Anti-Deficiency Act are subject to administrative sanctions, including removal from office and criminal penalties, where the violation is knowing and willful. 31 U.S.C. 1349(a), 1350.

Likewise, the question presented does not recur with enough frequency to warrant this Court's review. The Navy awarded the contract at issue here over 15 years ago, just nine days after the passage of Section 8118. Moreover, no funding restrictions similar to Section 8118 have been included in DOD appropriations acts since Fiscal Year 1993. Although similar funding restrictions are now included in DOD's regulations, 48 C.F.R. 235.006, there is no basis for assuming that DOD officials would violate the Department's governing regulations. Indeed, petitioners only cite to three cases pending in the Court of Federal Claims involving Section 8118 or its successor provisions, and those cases do not necessarily present the same issues as in this case. For example, in *Northrop Grumman Corp. Military Aircraft Div.* v. *United States*, No. 96-760C (Fed. Cl. filed Dec. 2, 1996), the contract was awarded

two years before Section 8118 was adopted and the contractor entered into a bilateral contract modification releasing its claims based on Section 8118. And in *CTA Inc.* v. *United States*, No. 96-113C (Fed. Cl. filed Feb. 23, 1996), the contract was not for "research and development" and therefore did not trigger any prior written determination concerning allocation of contract risk.

3. In any event, this case does not present an appropriate vehicle to consider whether a violation of Section 8118 constitutes a basis for reformation of the price of a fully performed contract, because petitioners are not entitled to any relief in any event. As the court of appeals held in the alternative, AT&T waived whatever claims it had to recovery of additional sums by failing to seek a different allocation of risk when the contract was awarded. Pet. App. 11a-14a. Indeed, although AT&T is a sophisticated government contractor, with over 1,000 contracts worth over $2 billion (*id.* at 11a), at no time before the contract was awarded did AT&T either request a cost-reimbursement contract or ascertain whether the DOD had issued the required written determination under Section 8118. Those omissions are fatal to any claim of recovery of AT&T's costs.

First, it is far from clear that the Navy would have awarded the contract to AT&T had the contract been awarded on a cost-reimbursement basis. AT&T "successfully underbid technically superior competitors to win the RDA contract." Pet. App. 12a. AT&T therefore "agreed, in essence, to assume the risk associated with its lower technical rating." *Ibid.* Accordingly, "[h]ad the contract required cost-reimbursement, * * * the Navy would have assumed the risk that AT&T's inferior technical capability would result in more costly performance," and might "have avoided that risk by

awarding the RDA contract to one of AT&T's technically superior competitors—a contingency of which AT&T surely was aware." *Ibid.*

Second, the court found that reformation of the contract on a cost-reimbursement basis "would not further the mutual intent of the parties" because the issuance of a cost-reimbursement contract would have been inexorably linked to closer government supervision over contract performance. Pet. App. 13a. "By performing the RDA contract on a fixed-price basis, AT&T avoided the costs of more intrusive government supervision. * * * Moreover, unlike money, these bargained for rights are not reallocable after performance." *Id.* at 12a-13a.

Third, "reformation of the RDA contract would cure the Navy's [S]ection 8118 noncompliance only at the expense of creating non-compliance with other statutory and regulatory provisions." Pet. App. 13a. As the court of appeals explained, had the Navy awarded the contract on a cost-reimbursement basis, relevant statutory and regulatory provisions would have prohibited the Navy from entering the contract without a prior determination that "no lower cost alternative existed." *Ibid.* "In short, the proper time for AT&T to have raised the issues that it now presents was at the time of contract negotiation, when effective remedy was available." *Ibid.* Particularly in those circumstances, petitioners could not make a showing that it is "unconscionable for the government to require performance of the original terms." *Id.* at 18a n.2 (Newman, J., dissenting).

Petitioners suggest (Pet. 26) that the court of appeals' holding that petitioners' actions constituted a waiver conflicts with the principle that courts do not enforce illegal contracts. The decisions cited by peti-

tioners, *Kaiser Steel Corp.* v. *Mullins*, 455 U.S. 72, 81 n.6 (1982), and *McMullen* v. *Hoffman*, 174 U.S. 639, 658 (1899), however, hold simply that courts will not enforce an agreement that itself involves an undertaking to violate the law, regardless whether the party resisting enforcement has objected to the illegality. By contrast, the subject matter of petitioners' contract was entirely lawful and provides no basis for relieving petitioners of the bargain they struck with the government.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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IN THE

Supreme Court of the United States

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
and
LUCENT TECHNOLOGIES INC.,
Petitioners,

v.

THE UNITED STATES,
Respondent.

On Petition For A Writ of Certiorari To The United States Court of Appeals for the Federal Circuit

PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY

Petitioners AT&T and Lucent offer the following points in response to the Government's opposition brief and in further support of their petition for a writ of certiorari:

1. ***The question presented is extraordinarily important to the nation's defense industrial base: Can the United States exploit a highly skilled defense contractor by knowingly awarding an illegal, economically predatory contract for development of a vital defense system and then, after the work is successfully completed, automatically escape all judicial redress when the aggrieved contractor seeks compensation for its enormous financial losses?*** Contrary to the impression that the Government's brief tries to create, this is *not* some isolated issue that has little relevance to the federal procurement system upon which our national defense depends. Instead, "[t]he defense contracting industry as a whole stands to suffer if the holding below stands." Br. of the Nat'l Defense Indus. Ass'n and the Gov't Electronics & Info. Technology Ass'n as *Amici Curiae* in Support of Petitioners at 17. The "Federal Circuit's decision will prevent defense contractors . . . from obtaining traditional and appropriate contract remedies when the contractors incur losses on illegal contracts or contracts with illegal terms." *Id.* at 1. Unless this Court restores clarity and sanity to this crucial area of federal procurement law by reviewing and reversing the opinion below, the already shrinking pool of high-tech defense contractors will be forced to seriously consider whether to forgo bidding on the very type of long-term, technologically challenging, R&D contracts that are essential to maintaining the nation's military superiority and homeland security.

The Government's brief acknowledges that the "fixed-price development contract" involved in this case "did not meet the conditions imposed by Section 8118" of the Defense Appropriations Act of 1988. U.S. Br. at (I); *see also id.* at 2. This blandly worded concession significantly

understates the grave, *illegal* nature of DoD's egregious actions here (and in the *many* other major defense procurements which violated § 8118 or its successors): Congress had "strong concern . . . over [DoD's] increasing use of fixed price-type contracts for engineering development" of major defense systems (a heavily criticized practice which flagrantly violated DoD's own longstanding acquisition guidelines), and the need to "maintain the government's credibility as a reliable business partner." H.R. Conf. Rep. No. 100-498 (1987), at 623. Following a House Appropriations Committee investigation and hearings, Congress enacted § 8118 as part of the 1988 defense appropriations statute to prevent *exactly* the type of financial abuse of contractors which subsequently occurred in this case – successful performance of a technologically demanding R&D contract (here, development of an "RDA" Soviet submarine surveillance system which the President's Annual Report to Congress for Fiscal Year 1987 (p. 188) described as "[o]ne of our most important ongoing programs") at a cost *far in excess* of the fixed contract price which DoD *compelled* the contractor to propose.

As the Government's brief explains, § 8118 "provided that appropriated funds *could not be obligated or expended* for major fixed-price development contracts unless the Under Secretary of Defense for Acquisition" first determined, in writing, that "realistic pricing can occur," and also that "the contract type permits an equitable and sensible allocation of program risk between the contracting parties." U.S. Br. at 2 (emphasis added). In other words, the plain language of § 8118 conveyed Congress' unequivocal intention to *protect defense contractors* by making appropriated funds available for fixed-price development contracts *only if* the upper echelon of DoD first made this required written determination. By purporting to award the RDA contract on a fixed-price basis in the absence of the required determination, DoD unlawfully, and quite possibly unconstitutionally, obligated and expended funds which *had not been made available by Congress* (i.e., which exceeded

the funds appropriated by Congress) for obligation or expenditure on major defense contracts. This is precisely the sort of conduct which the Government's brief indicates violates the Anti-Deficiency Act, an organic statute rooted in Congress' "power of the purse." *See* U.S. Br. at 10 (citing 31 U.S.C. § 1341(a)(1)); U.S. Const. art. I, § 9, cl. 7; *see generally Hercules, Inc. v. United States*, 516 U.S. 417, 427 (1996) ("The Anti-Deficiency Act bars a federal employee or agency from entering into a contract for future payment of money in advance of, *or in excess of,* an existing appropriation.") (emphasis added); *Thompson v. Cherokee Nation*, No. 02-1286, 2003 WL 21511710, at *15 (Fed. Cir. July 3, 2003) ("if an agency, 'in the absence of statutory authority, make[s] promises that impose an obligation on the federal Treasury, [it] exceed[s] [its] constitutional authority and abrogate[s] Congress' authority under the Appropriations Clause' ") (quoting *Schism v. United States*, 316 F.3d 1259, 1288 (Fed. Cir. 2002)).

For this reason, as the Court of Federal Claims ("CoFC") held at the outset, the RDA contract was void *ab initio*. *See AT&T I* (Pet. App. at 127a-128a) ("absent compliance with the written determination requirement of Section 8118, *no authority to obligate funds came into being* and thus *no valid contract* was created") (emphasis added). The "multitude of opinions by the members of the Federal Circuit in this case" (U.S. Br. at 9), reflect that court's long struggle, striking indecision, and strong internal disagreement – which only this Court can resolve – regarding what to do about a fully (and successfully) performed defense contract that was void *ab initio* due to DoD's surreptitious violation of a mandatory prohibition in an appropriations statute. Although DoD's *admitted* violation of § 8118 caused AT&T to incur a huge financial loss, the Government's brief asserts that "not one appellate judge has expressed the view that petitioners are entitled to any relief in this case." U.S. Br. at 9. But that is not surprising since the Government thus far has succeeded in depriving Petitioners of a trial on their claims for relief. As

Judge Newman, who authored the *AT&T III en banc* opinion which "remanded [this case] to the [CoFC] for consideration of the question of relief," emphasized in her sharply worded dissenting opinion below, "AT&T has not yet had its day in court." Pet. App. at 16a, 18a.

Mimicking the majority opinion below, the Government's brief asserts that Petitioners are not entitled to relief because of "[t]he absence of any right of action to enforce Section 8118." U.S. Br. at 7. The Government cavalierly asserts that § 8118 was not enacted "for the benefit of private defense contractors." *Id.* at 8 n.2. To the contrary, § 8118, by its very nature, "[q]uite plainly . . . has more than the Government's own interests in mind[;] [it] encompasses the interests of both parties – *contractors* as well as the Government." *AT&T I* (Pet. App. at 121a) (emphasis added). The Government's brief also repeats the majority opinion's reference to supposedly relevant *post hoc* "legislative history" authored by a Senate committee that was not responsible for enactment or oversight of § 8118 or its successors. *See* U.S. Br. at 7. As the petition explains, the committee report in question specifically stated that it was not intended to affect the requirements of § 8118, which DoD, by its own admission, violated here. *See* Pet. at 25-26.

The Government's brief also asserts that the opinion below is consistent with the "principle that a contract that the government unlawfully entered into does not *automatically* entitle the contractor to judicial relief." U.S. Br. at 8 (emphasis added). Petitioners do not contend, however, that they are "automatically" entitled to relief; what they contend is (i) that the RDA contract (or its pricing term) was invalid due to DoD's violation of § 8118, and (ii) that they have brought valid claims (under the Contract Disputes Act and Tucker Act), and have the right to pursue them.

The Federal Circuit erroneously held, however, that because the procurement-related statute that has been violated (i.e., § 8118) does not contain an *explicit* right of action, Petitioners' claims must be automatically dismissed.

Pet. App. at 6a-7a. The Government's brief attempts to downplay the *drastic*, *unprecedented* nature of this holding, for example, by interjecting the red herring that the panel majority also indicated that there is no implicit right of action in § 8118. U.S. Br. at 8. But only last month, the Government filed a summary judgment reply brief in *Gould, Inc. v. United States*, No. 95-88C, a CoFC case involving an allegedly illegal contract, in which the Government, relying upon the *AT&T V* opinion below, argued that absence of an explicit right of action in the defense appropriations act was *determinative*:

> Here, like AT&T, there is *no explicit right of action* in the language of the Act. . . . The focus must first be with the *explicit language* of the statute itself. *If no private right of action is recited, then none exists.*

Def. Reply Br. at 6, 7 (filed June 2, 2003) (emphasis added).

If allowed to stand, the Federal Circuit panel majority's new rule regarding the need for an explicit right of action in the appropriations or other procurement statute that has been violated will continue to engender inconsistency, uncertainty, and confusion, if not an impassable roadblock, whenever an aggrieved contractor files a claim against the United States alleging that a contract or contract term is illegal. *See* Pet. at 18-24; Br. of *Amici Curiae* at 3-14. The Federal Circuit's exclusive jurisdiction over such claims only heightens the need for this Court's immediate review.

2. *The Government's assertion that "the question presented does not recur with enough frequency to warrant this Court's review" (U.S. Br. at 10) is disingenuous.* As the Government is aware, this is hardly the only suit in which a defense contractor has sought relief based on DoD's violation of § 8118. *See, e.g., Northrop Grumman Corp. v. United States*, 47 Fed. Cl. 20, 48-49 (2000) (holding that "[b]y failing to make risk determinations . . . DoD violated the statutory prerequisites for the funding of this fixed-price

incentive contract"). Nevertheless, according to the Government, Petitioners cite "only" three pending CoFC cases involving § 8118 or its successors, "and those cases *do not necessarily present the same issues* as in this case." U.S. Br. at 10 (emphasis added). But in those cases, which collectively add up to a ***billion dollars*** in pending claims against the United States (*see* Pet. at 14), the Government has *seized* upon the *AT&T V* opinion below *as dispositive authority*. For example, two weeks after the opinion was issued, the Government requested leave to submit it as supplemental authority supporting summary judgment in *Short Bros., PLC v. United States,* No. 98-894C. The Government asserted that "in AT&T, the Federal Circuit *rejected the very claim* that forms the basis of Count 1 of plaintiff's complaint in this case." Def. Motion for Leave to File Suppl. Auth. at 2 (filed Oct. 24, 2002) (emphasis added). In a subsequent brief in the same case, the Government argued "that plaintiff's *attempt to distinguish* the AT&T decision is *without merit*." Def. Motion for Leave to Submit a Reply at 4 (filed Nov. 8, 2002) (emphasis added).

CTA Inc. v. United States, No. 96-113C, is another pending § 8118 case which the Government here duplicitously implies is readily distinguishable (U.S. Br. at 11). The CoFC, at the joint request of the Government as well as the contractor, has held all proceedings in abeyance since April 2001, including a ruling on the parties' summary judgment motions, pending the final outcome of *AT&T*. In the parties' most recent joint status report, prepared and filed by the Department of Justice, the Government notified the court that "*both parties* believe that it would be *appropriate to wait* until the *AT&T* decision has become final . . . before advising this Court regarding further proceedings in this case." Joint Status Report at 2 (filed June 6, 2003) (emphasis added). As far back as 1996 "the parties stated the decision from the . . . Federal Circuit [in *AT&T*] may have a *significant impact on the outcome of this case*." Order (filed April 3, 2001) (emphasis added). The Government's

brief to this Court, however, misleadingly suggests that the opinion below is inapposite to *CTA*.

Northrop Grumman Corp. Military Aircraft Div. v. United States, No. 96-760C, is yet another § 8118 case (involving claims exceeding $750 million) which the Government's brief attempts to distinguish here (U.S. Br. at 10-11). The CoFC has stayed the Government's Partial Motion to Dismiss, however, and directed the Government to file a notice regarding the status of the *AT&T* certiorari petition within five days of any action taken by this Court. Order (filed May 14, 2003).[1]

Equally significant, but astonishingly, undisclosed in its brief to this Court, the Government has been *aggressively* utilizing the opinion below as the centerpiece of its efforts to achieve dismissal of ***billions*** of dollars in pending contractor claims involving alleged DoD violations of ***other*** procurement statutes or regulations. For example, in *Gould, Inc. v. United States*, No. 95-88C, the Government's recent summary judgment reply brief argues to the CoFC that "the statute in AT&T was a funding statute, *similar in material respects* to the statute at issue here." Def. Reply Br. at 4 (filed June 2, 2003) (emphasis added); *see also* Pet. at 15. And although the Government's opposition brief here asserts that the Federal Circuit's holding in *AT&T V* "is neither remarkable nor novel" (U.S. Br. at 9), its reply brief in *Gould* vigorously argues to the contrary. According to the Government's *Gould* brief, *AT&T V* effectively overruled the Federal Circuit's earlier holding in *Gould, Inc. v. United*

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[1] Section 8118 also has been an issue in the long pending "A-12" litigation, in which several **billion** dollars are at stake. *See McDonnell Douglas Corp. v. United States*, 323 F.3d 1006, 1010-12 (Fed. Cir. 2003) (discussing case background). The litigation involves the Navy's award in 1988 of "a fixed-price contract . . . to research and develop a carrier-based 'stealth' attack aircraft called the 'A-12 Avenger.' " *Id.* at 1010.

States ("Gould IV"), 67 F.3d 925 (Fed. Cir. 1995), that the contractor has stated a claim upon which relief can be granted. More specifically, the Government's *Gould* reply brief, referring to *AT&T V*, argues that "[e]ven if [the] law of the case arguably applied here, there is no occasion to enforce it because *subsequent controlling authority has changed the law*." Def. Reply Br. at 4 (emphasis added). To underscore that the *AT&T V* opinion represents a sea change in federal procurement law, the Government's *Gould* brief attempts to dispose of prior Federal Circuit cases involving illegal contract terms as "pre-AT&T decisions." *Id.* at 16. Thus, the Government's recent arguments in *Gould* belie its efforts here to minimize the far-reaching significance of the opinion below.

Moreover, there are additional recent cases, unrelated to § 8118, in which the Government has brandished the opinion below in efforts to deprive contractors of their day in court. For example, in *La Gloria Oil and Gas Co. v. United States,* 56 Fed. Cl. 211, 226 (2003), the Government, citing *AT&T V*, "argue[d] for the first time . . . that [the contractor] has waived its right to challenge the legality of the EPA [economic price adjustment clause] used in its contracts." *See also C.W. Over & Sons, Inc. v. United States*, 54 Fed. Cl. 514, 522-23 (2002) (adopting the Government's *AT&T V* waiver argument). *La Gloria* is only one of the pending "jet fuel" cases. Alleging that they were underpaid because of DoD's use of an illegal EPA clause in military jet fuel supply contracts, about 25 oil companies have filed claims against the United States totaling more than **$2 billion**. *See* Jeremy Feller, *Sunoco Sues U.S. Over Fuel*, Philadelphia Business Journal, May 20, 2002.

Congress routinely enacts defense procurement legislation which prohibits use of particular contract types or terms. *See, e.g.*, 10 U.S.C. §§ 2304b(b) (task order contracts exceeding five years), 2306(a) (cost plus percentage of cost contracts), 2401(c) (long-term lease or charter of aircraft or naval vessels). Unless this Court reviews and reverses the

Federal Circuit's opinion below, the Government will continue to wield *AT&T V* as a weapon which can summarily terminate any claim alleging that DoD violated a statutory or regulatory requirement or prohibition governing pricing or other material terms of defense contracts.

3. *There is no basis for the Government's contention that Petitioners have waived their entitlement to relief.* Relying upon majority opinion *dicta*, the Government, *which admits that it violated § 8118*, asserts that AT&T "waived whatever claims it had to recovery" because it did not object to the contract's fixed-price basis "before the contract was awarded." U.S. Br. at 11 (citing Pet. App. at 11a-14a). But there was *no way for AT&T to have known* that the Under Secretary of Defense for Acquisition had not made the "realistic pricing" and "equitable and sensible allocation of program risk" determination required by § 8118, a statute which the Government's brief emphasizes was enacted "just nine days" before the contract was awarded on New Year's Eve, 1987. *Id.* at 2. Because AT&T was not aware of DoD's violation of § 8118 when the contract was awarded, it had no basis for objecting. (AT&T did object after learning of the violation (*see* Pet. at 7-8).)

Nor would it have been rational for AT&T, which was *competing* for the RDA project, to "request a cost-reimbursement contract" (U.S. Br. at 11) in response to DoD's solicitation for "competitive bidding" on a "fixed price incentive fee contract." Pet. App. at 35a. Indeed, DoD's "solicitation specified that award would be made to the offeror deemed most advantageous to the government, technical risk, *price*, and other factors considered." *Gould, Inc. Ocean Sys. Div.*, B-229965, 88-1 CPD ¶ 457 at 2 (May 16, 1988) (emphasis added). As with virtually all competitively bid DoD contracts, there was simply no room for negotiation regarding the type of contract to be awarded. *See* Pet. at 4.

The Government's brief (U.S. Br. at 11-12) also relies upon what Judge Newman's dissenting opinion

accurately describes as the majority's "strange" and "speculative theories" (*none* of which, she emphasized, are based on "evidence or findings" in the record) as to why AT&T somehow has waived the right to claim additional compensation simply because it was the low bidder on the contract. Pet. App. at 17a. To support these theories, the Government asserts that "[a]lthough the Navy determined AT&T's proposal to be *technically inferior* to that of a competitor [Gould], the Navy awarded the contract to AT&T based upon the significantly reduced price offered by AT&T." U.S. Br. at 2 (emphasis added). In denying Gould's protest against the award to AT&T, however, the Comptroller General's decision explains that "the contracting officer properly looked *behind* the technical scores of Gould and AT&T and found that the 4-point advantage enjoyed by Gould . . . *did not reflect technical superiority*." *Gould, Inc. Ocean Sys. Div.*, *supra* at 5 (emphasis added). Thus, the Government's (and lower court's) premise that AT&T underbid "technically superior competitors" (U.S. Br. at 11) is outrageously incorrect.

Moreover, it was well settled until *AT&T V* that the Government may not benefit by violating a procurement statute. "The contractor cannot, by waiver, permit the Government to enter an illegal contract . . . When a contract clause drafted by the Government is inconsistent with law, whether the [contractor] inquired, protested, accepted or otherwise assumed any risks regarding the same is not controlling; the impropriety will not be allowed to stand." *Mapco Alaska Petroleum, Inc. v. United States*, 27 Fed. Cl. 405, 416 (Ct. Cl. 1992) (citation omitted); *see also Beta Sys., Inc. v. United States*, 838 F.2d 1179, 1186 (Fed. Cir. 1988) (Government cannot benefit even if contractor knowingly agreed to an illegal contract term); Pet. at 26; Br. for *Amici Curiae* at 18-20. Having vastly profited from its brazen disregard of § 8118 to the great financial detriment of a defense contractor whose interests that statute was supposed to protect, the Government cannot now shroud its unclean hands with a flimsy assertion of waiver.

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THE UNITED STATES,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

BRIEF OF THE NATIONAL DEFENSE INDUSTRIAL ASSOCIATION AND THE GOVERNMENT ELECTRONICS AND INFORMATION TECHNOLOGY ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF THE *AMICI CURIAE*[1]

Amicus curiae National Defense Industrial Association (NDIA) is a nonpartisan, nonprofit international organization representing more than 1000 companies and 24,000 individuals from the defense and national industrial bases. NDIA's mission is to provide a forum for the interchange of ideas between the government and industry to address problems of joint concern, including business and technical aspects of the government acquisition and procurement process. NDIA members support our national defense by contracting with the government to provide vital military equipment, weapons, and machinery.

Amicus curiae Government Electronics and Information Technology Association (GEIA) is an organization of "high-tech" companies that contract to provide the government with electronics and information technology solutions. Members of GEIA have thousands of contracts with the federal government and derive a substantial percentage of their annual revenues from these contracts.

NDIA and GEIA believe that the Federal Circuit's decision will prevent defense contractors, including members of *amici* organizations, from obtaining traditional and appropriate contract remedies when the contractors incur losses on illegal contracts or contracts with illegal terms. Some members of *amici* organizations face in other litigation the same issue that is before the Court in the petition.

STATEMENT

This litigation arises out of a contract entered into at the end of 1987 between petitioner AT&T, a defense contractor, and the United States Navy, to engineer and develop the "Reduced Diameter Array," a subsystem of the "Surveillance Towed-Array Sensor System," designed to detect the most advanced

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[1] The parties' letters of consent to the filing of this brief have been lodged with the Clerk of the Court. Pursuant to Rule 37.6 of the Rules of this Court, *amici curiae* state that no counsel for a party has written this brief in whole or in part and that no person or entity, other than the *amici curiae*, their members, or their counsel, has made a monetary contribution to the preparation or submission of this brief.

Soviet submarines. Pet. App. 34a-35a.[2] The contract was a "fixed-price" contract under which petitioner committed to do all research, development, and testing, and to deliver an "engineering development model." Petitioner successfully performed the contract at a total cost vastly in excess of the fixed contract price (even after certain adjustments). *Ibid.*

A completely lawful fixed-price contract, of course, would have placed on petitioner the risk that the cost of this cutting-edge research and development would be much more than the price. But the price term of contract at issue was *not* lawful, precisely because Congress was fed up with the Navy's practice of routinely putting such risks entirely on contractors. The fixed-price term in the contract violated the Defense Appropriations Act of 1987, Pub. L. No. 100-212, § 8118, 101 Stat. 1329-84 (Section 8118), which provided in part:

> None of the funds provided for the Department of Defense in this Act may be obligated or expended for fixed price-type contracts in excess of $10,000,000 for the development of a major system or subsystem unless the Under Secretary of Defense for Acquisition determines, in writing, that program risk has been reduced to the extent that reasonable pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties[.]

Petitioner sued in the Court of Federal Claims, seeking to have the contract reformed into a "cost reimbursement" contract, to correct the illegal price term. In the alternative, petitioner sought relief in *quantum meruit* for the value of the benefit conferred on the Navy. Pet. App. 109a.

The litigation ultimately made it to the *en banc* Federal Circuit, which held in an opinion by Judge Newman that the

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[2] Though both AT&T and Lucent Technologies are petitioners, there was only one contract, and we will refer to "petitioner" to avoid confusion. No issue before the Court turns on any difference in the interests of AT&T and Lucent.

illegal price term did not render the entire contract void *ab initio*. Pet. App. 48a. The court also stated the various remedies potentially available to a contractor that has fully performed its responsibilities under a contract that contains an illegal term, including sustaining the contract, reforming the contract, and granting recovery under an implied-in-fact contract. *Ibid.*

On remand, the Court of Federal Claims dismissed the suit for failure to state a claim. A Federal Circuit panel affirmed over a strong dissent by Judge Newman, the author of the *en banc* opinion. Pet. App. 2a. The panel held that petitioner's ability to bring a cause of action seeking a remedy on the contract turned on whether Section 8118 was intended to be "enforced" through private lawsuits. *Id.* at 8a. The panel also suggested that petitioner had waived any right to contest the price term in the contract by failing to protest the form of the contract during the bidding process. *Id.* at 13a-14a.

The unsettled state of the law within the Federal Circuit demonstrates a need for this Court to intervene. Because the complaint has been dismissed for failure to state a claim (after ten years of litigation), the petition presents a pure issue of law for this Court's review. This case is therefore an excellent vehicle for this Court to answer the simple, broadly applicable question whether an aggrieved contractor can pursue contract-law remedies when one or more terms of the contract are illegal.

ARGUMENT

I. REVIEW IS NEEDED TO ADDRESS THE CONFUSION REGARDING A CONTRACTOR'S RIGHT TO A REMEDY WHEN A CONTRACT OR ITS TERMS ARE INVALID

It is impossible to overstate the radical nature of the decision below. The panel majority did not hold that some *particular* contract remedy is unavailable *on the facts* of this case. Rather, it held that *all* contract remedies are unavailable unless the statute making a contract term illegal gives rise to an express or implied private right of action. No corresponding doctrine shackles the government's right to use self-help or otherwise

obtain relief when it discovers that *it* would be better off without an illegal contract term. This new doctrine that the contractor always (or almost always) loses when a contract contains an illegal term is alarming to *amici*, and provides disincentives for the government to adhere to the will of Congress when entering into any of an enormous variety of contracts.

When one side has fully performed its obligations under the contract, and the price term of the contract is illegal, it makes no sense to interpret *the statute rendering the term illegal* – rather than the Contract Disputes Act, which allows an aggrieved government contractor to sue – to determine whether the aggrieved contractor can sue *in contract or quasi-contract*. The panel below has – over a strong dissent by Judge Newman, the author of a prior *en banc* opinion in this same case – followed a train of reasoning that undermines the common law and the legal scheme understood and relied on by the defense contracting industry. In so doing, the panel created and applied special rules applicable only to government contracting, although this Court has recently noted that the United States is not exempt from the body of law that applies generally to contracts between private individuals. *Mobil Oil Expl. & Prod. Southeast, Inc.* v. *United States*, 530 U.S. 604, 607-608 (2000) (citing *United States* v. *Winstar Corp.*, 518 U.S. 839, 895 (1996) (plurality opinion)).[3]

The holding below breaks from this Court's decision in *Clark* v. *United States*, 95 U.S. 539 (1877), where a contractor

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[3] See also *Marathon Oil Co.* v. *United States*, 177 F.3d 1331, 1341 (Fed. Cir. 1999) (Newman, J., dissenting) (urging application of "simple contract principles" to hold government fiscally responsible for making contract impossible to perform), rev'd *sub nom. Mobil Oil Expl.& Prod. Southeast, Inc.* v. *United States*, 530 U.S. 604 (2000). Judge Newman's dissenting opinion in *Marathon*, disagreeing with Judges Plager and Rader, was issued 13 days before her *en banc* opinion in this case, disagreed with by Judges Rader (in concurrence) and Plager (in dissent). This Court vindicated Judge Newman's view. The issues in *Marathon* (*Mobil*) and this case are not the same, but in both cases Federal Circuit judges have advanced special rules to help the government escape ordinary contract doctrines.

was held entitled to *quantum meruit* recovery from the government when the express contract was unenforceable because it was not (as required by statute) in writing. The decision below also conflicts with the Federal Circuit's own recent decisions, including *Barrett Refining Corp.* v. *United States*, 242 F.3d 1055 (Fed. Cir. 2001), holding that *quantum valebant* recovery is available to a contractor that has fully performed a contract with an illegal price term. And the final panel decision below, which does not even follow the logical path on which the *en banc* court set the litigation, is the result of misguided attempts to apply a confused body of Federal Circuit case law. The inconsistency in rules regarding an aggrieved contractor's right to a remedy against the federal government, in the circuit with exclusive appellate jurisdiction over these cases, puts members of *amici* organizations out to sea with little confidence that the rules applied in one case can also be relied on in any future situation. The inconsistency will remain unless this Court grants review to clear up the confusion.

A. *Courts Regularly Replace Invalid Contract Terms with Implied Terms.* The process of discerning implied contract terms to supplant those that are invalid by operation of law has long been recognized. See *Clark*, 95 U.S. at 542 (allowing recovery "as upon an implied contract for a *quantum meruit*" for full performance of obligations under a contract that was unenforceable under a federal statute requiring military contracts to be in writing). This well-established doctrine, under which government contractors are subject to and may rely on the same body of contract law that regulates the dealings of private parties, has heretofore been the basis of the defense contracting industry's understanding of its legal rights in cases like the one before the Court. See *Winstar Corp.*, 518 U.S. at 895 & n.39 (plurality opinion) (citing cases).

Under the modern procurement contracting framework, the availability of a suit on a contract by an aggrieved contractor against the United States government is beyond cavil. The Tucker Act is an express grant of jurisdiction to the Court of Federal Claims for suits "upon any express or implied contract

with the United States." 28 U.S.C. § 1491(a)(1); see *Hercules, Inc.* v. *United States*, 516 U.S. 417, 423 (1996). And the Contract Disputes Act (CDA), 41 U.S.C. §§ 601-613, applies to "any express or implied contract * * * entered into by an executive agency for * * * the procurement of property" (Section 602(a)(2)), and allows a contractor to "bring an action directly on the claim in the United States Court of Federal Claims" (Section 609(a)(1)); see *Cessna Aircraft Co.* v. *Dalton*, 126 F.3d 1442, 1447 (Fed. Cir. 1997); see also *National Park Hospitality Ass'n* v. *Department of Interior*, 123 S. Ct. 2026, 2028-2029 (2003). Such contract claims against the United States are "grounded in the CDA." *Cessna*, 126 F.3d at 1447. But the Federal Circuit, in its most recent opinion below, ignored petitioner's right of action under the CDA and asked instead whether Section 8118 provided a private right of action.

When the operation of law has rendered a term of a purported contract invalid, a court will ask whether the party asserting the right to recovery can establish the existence of the contract based on well-understood contract principles. See *Hercules*, 516 U.S. at 423-424. Proof of an implied-in-fact contract requires proof of the elements of an express agreement – including consideration, mutuality of intent, and definiteness of terms. *Girling Health Sys., Inc.* v. *United States*, 949 F.2d 1145, 1146-1147 (Fed. Cir. 1991). This Court and lower courts have readily found that the contract is proved when it "has been wholly or partially executed and performed on one side." *Clark*, 95 U.S. at 542; see *Gould Inc.* v. *United States*, 67 F.3d 925, 930 (Fed. Cir. 1995) (*Gould II*) ("[A] contractor can be compensated under an implied-in-fact contract when the contractor confers a benefit to the government in the course of performing a government contract that is subsequently declared invalid."). Once the contract is proved, the illegal terms are replaced with implied terms as necessary for the agreement to be complete. See *ibid.* ("[I]t is only fair and just that the Government pay for goods delivered or services rendered and accepted under [the contract]."); *Clark*, 95 U.S. at 542.

The doctrine of contract reformation is also used in suits under the CDA. *Beta Sys., Inc.* v. *United States*, 838 F.2d 1179, 1185 (Fed. Cir. 1988). In *Beta Systems*, an economic price adjustment clause in a procurement contract was invalid for violating the Defense Acquisitions Regulation (DAR). *Id.* at 1184. If left untouched, the invalid clause would have inured to the government's benefit at the expense of the contractor. *Id.* at 1185. The court held that it was mutual mistake of the parties that allowed the illegal term to find its way into the contract, and that contract reformation was available to alter the price clause such that it would not violate the DAR. *Id.* at 1186.

B. *The Tortured Litigation Below Reflects the Confusion in the Federal Circuit Case Law.* The tortured history of this litigation, culminating in the panel decision below – holding that petitioner's right of recovery on its contract is determined by whether Section 8118 provides a private right of action – demonstrates the problems inherent in allowing the tangle of different rules promulgated by the Federal Circuit and the Court of Federal Claims to exist side by side.

The fact of the Navy's violation of Section 8118 in its contract with petitioner, as well as other contracts currently in litigation, is not a matter of dispute, but the issue presented in the petition – whether contract remedies are available to an aggrieved government contractor suing under the CDA – has utterly confounded the courts below. In five decisions producing nine separate opinions, the Federal Circuit and the Court of Federal Claims have variously held:

(1) the violation of Section 8118 rendered the contract void *ab initio*, and recovery should be allowed to the contractor on a *quantum meruit* basis (Court of Federal Claims, see Pet. App. 104a-135a);

(2) the violation rendered the contract void *ab initio*, and the Court of Federal Claims may not award equitable relief on a contract claim, so the case should be dismissed (see Pet. App. 75a-103a (Plager, J., over dissent by Newman, J.));

(3) despite the Navy's violation of Section 8118, the contract was *not* void *ab initio*, and on remand the Court of Federal Claims should consider what contract remedy is available to the contractor (see Pet. App. 33a-72a (Newman, J., with concurrence by Rader, J., and over dissent by Plager, J.));

(4) the valid contract contained a pricing provision violating Section 8118, but Section 8118 does not create a cause of action in favor of the aggrieved contractor, so the suit should be dismissed for failure to state a claim (Court of Federal Claims, see Pet. App. 21a-32a); and

(5) Section 8118 was violated, but is to be enforced through legislative oversight, rather than through a private right of action; also, the contractor waived any argument that the price clause of the contract is invalid, so the dismissal for failure to state a claim is affirmed (see Pet. App. 1a-18a (Rader, J., over dissent by Newman, J.)).

The multitude of different holdings, and inconsistency between the holdings, reflects the extraordinary uncertainty to which contractors are subjected when evaluating contracting opportunities.

The most recent (and, unless reviewed by this Court, case-dispositive) panel decision creates conflict with several of the Federal Circuit's own recent precedents. Presented with an opportunity to resolve the conflict by again taking this case *en banc*, the Federal Circuit denied the petition for rehearing. Pet. App. 19a-20a. As petitioner correctly observes (Pet. 22), such intra-circuit inconsistency takes on special importance – for purposes of this Court's review – when the case arises within the Federal Circuit's exclusive jurisdiction.

In *Barrett Refining*, another panel of the Federal Circuit – on which the author of the opinion below sat – took a functionally identical scenario and reached a result diametrically opposed to the panel decision below. *Barrett Refining* relied in part on the *en banc* decision in the litigation now before the Court to conclude that a contract with an illegal price term was

not void *ab initio*, and then held that recovery *was available* in *quantum valebant*. *Barrett Refining* involved four supply contracts between the plaintiff contractor and the United States to supply military jet fuel. *Id.* at 1058. The price term in the contracts involved a base price plus a price adjustment clause, but the price adjustment clause turned out to be unenforceable for violating the Federal Acquisitions Regulations. *Ibid.* After the contractor had fully performed under the contracts, and the base price of the contract was paid, the contractor sued seeking damages for the difference between the base price and the actual fair market value of one contract. *Ibid.* The United States counterclaimed, seeking to collect the amount that it had paid in excess of fair market value on the three other contracts. *Ibid.* The court held that the invalid price clause in the contract did not render the contract void *ab initio*, relying in part on the *en banc* decision in the litigation before the Court. *Id.* at 1060 n.2 ("The determination * * * that only the price escalation term was unenforceable and invalid, and that the entire contract was not invalid, is consistent with our case law." (citing *AT&T* v. *United States*, 177 F.3d 1368 (Fed. Cir. 1999) (*en banc*))). The *Barrett Refining* court then held that the parties were operating under a contract, so an implied price term could be discerned – and *quantum valebant* relief was available. *Id.* at 1059 (citing *Northrop Grumman Corp.* v. *United States*, 47 Fed. Cl. 20, 40-41 (2000)).[4] The court held that both the contractor and the government should be allowed to prove on remand that the fair market price differed from the base price that was paid.

Cessna Aircraft also *expressly rejects* the Navy's argument that a contractor "lack[s] standing to contest matters relating to

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[4] *Barrett Refining* relied on *Northrop Grumman* to support its holding that *quantum valebant* relief was an available remedy in a suit on an implied-in-fact contract. *Northrop Grumman* is one of the Section 8118-type cases that, were it still in litigation, would be forced to navigate the inconsistent Federal Circuit decisions in this case. See 47 Fed. Cl. at 35-36 (contract was subject to the versions of Section 8118 enacted for fiscal years 1990-1992).

the Navy's compliance with funding statutes" unless a "private right of action exists under the * * * Act with respect to such matters." 126 F.3d at 1447. The contractor in that case sued claiming loss because the Navy entered a contract in violation of the Antideficiency Act. Specifically, the contractor argued that the Antideficiency Act prohibited a particular price clause in a multi-year contract to provide training for "undergraduate naval flight officers." In rejecting the Navy's argument that the contractor must demonstrate the existence of a private right of action under the Antideficiency Act, the court held that the suit was brought under the CDA, on an implied-in-fact contract theory, and should be permitted. *Ibid.* "Cessna's claims [are] 'grounded in the CDA.' * * * The fact that Cessna argues that the Navy violated the Antideficiency Act and attendant regulations * * * [does] not mean that Cessna is seeking relief under the Antideficiency Act." *Ibid.* Although the court then held that the Antideficiency Act had not been violated (*id.* at 1452), Part II of its opinion (*id.* at 1447-1448) stood, until now, as the Federal Circuit's definitive rejection of the argument the Navy has now successfully pressed on a divided panel.

In *Gould II*, the contractor won a bid for a multi-year contract to produce radios for the Navy according to certain specifications. 67 F.3d at 927. The specifications were claimed to be inadequate, and the contractor incurred development costs significantly in excess of the fixed contract price. *Ibid.* The contractor argued that the Navy's failure to supply a "stable design" for the contract rendered the contract illegal under a statute requiring the agency head to find "'that there is a stable design for the property to be acquired and that the technical risks associated with such property are not excessive.'" *Ibid.* (quoting 10 U.S.C. § 2306(h)(1)(D)). The Navy argued in response that such an illegality meant that the contracting officer lacked *authority* to enter the contract. *Id.* at 929. But "'it is only fair and just that the Government pay for goods delivered or services rendered and accepted under'" the contract. *Id.* at 930 (quoting *United States* v. *Amdahl Corp.*, 786 F.2d 387, 392-393 (Fed. Cir. 1986)). The court held that, if the

contractor had rendered performance under a contract with an illegal price term, the contractor was entitled to relief under an implied-in-fact contract. *Ibid.*

Had the panel decision below followed, somehow distinguished, or even disagreed with the court's precedents allowing implied-in-fact contract relief – and specifically rejecting any rule that would require the term-invalidating statute to provide for a private cause of action – contractors and future litigants would at least have some definite rules by which to conduct their business. Another *en banc* opinion could have definitively reconciled the conflict. But the Federal Circuit's failure to clean its own house allows the uncertain state of the law to remain, and calls for review by this Court.

C. *The Failure To Apply Contract Doctrine To This Case Is Wrong.* Not only does the confused assortment of rules regarding what to do when a government contract includes an illegal term or illegal terms warrant review in order to provide clarity and consistency in the field, the decision below is manifestly incorrect and should be reversed. The fallacy in the lower courts' reasoning does not turn on their understanding of Section 8118. The fallacy is in over-complicating this case, which raises *nothing more* than a contract-law question of what measure of compensation is due to a contractor that has fully performed its obligations under a valid contract when the price term of the contract is declared illegal – or otherwise unenforceable (see *Clark*, 95 U.S. at 542).

"[W]here a parol contract has been wholly or partially executed and performed on one side, the party performing * * * will be entitled to recover such value as upon an implied contract." *Clark*, 95 U.S. at 542. Petitioner's right to a remedy in this case is a creature of contract law, to which the United States Government is subject when it chooses to enter into the domain of commerce. See *Mobil Oil Expl.*, 530 U.S. at 608; *Winstar*, 518 U.S. at 895 & n.39 (plurality opinion). Section 8118 plays a role – like the statute at issue in *Clark*, where a contract for the rental of the plaintiff's steamship was unenforceable because not reduced to writing – of stating that the price term in the con-

tract cannot be enforced as written. A suit on the contract is brought under the CDA, and jurisdiction is vested in the Court of Federal Claims by the Tucker Act. And the rules of contract law applicable to implied-in-fact contracts state that when one party to a contract has fully performed its obligations, and the other party has accepted performance while at all times acting as if under a contract, the fact that the contract contains illegal or unenforceable terms does not erase the contractor's right to recovery. See *Clark*, 95 U.S. at 544; *Gould II*, 67 F.3d at 930 (contractor should be given the opportunity to prove that it conferred a benefit while performing a contract with the government and that its performance entitles it to relief). In addition to implied-in-fact contract, the contract reformation doctrine permits a court to rewrite an invalid term in order to do justice to the parties' intent. See, *e.g.*, *LaBarge Prods., Inc.* v. *West*, 46 F.3d 1547, 1552 (Fed. Cir. 1995). The manifest injustice to petitioner and to myriad others similarly situated, including members of *amici* organizations, of permitting the government not to compensate contractors fairly for their products and labors, also counsels for this correct application of contract law.

In addition to the authorities discussed above, many decisions of the Federal Circuit and other federal courts permit recovery on an implied-in-fact contract when one or more terms of a contract are illegal by operation of law. See *Gould, Inc.* v. *United States*, 935 F.2d 1271, 1275 (Fed. Cir. 1991) (*Gould I*) ("A court may grant equitable relief under an illegal contract if the government received a benefit from the contractor's performance."); *Amdahl Corp.*, 786 F.2d at 395 ("[W]here conforming goods or services have been delivered by a contractor and accepted by the government, the contractor has been held entitled to payment."); *Urban Data Sys., Inc.* v. *United States*, 699 F.2d 1147 (Fed. Cir. 1983); *Campbell* v. *TVA*, 421 F.2d 293 (5th Cir. 1969). The Federal Circuit has also regularly granted contract reformation to correct illegality. See *Beta Sys.*, 838 F.2d at 1185 (reformation was appropriate when the price adjustment clause did not cover contractor's costs); *Applied Devices Corp.* v. *United States*, 591 F.2d 635, 641 (Ct.

Cl. 1979) (plaintiff contractor was entitled to an equitable reformation of the cancellation ceiling under the contract because the contract was made in violation of law); *Chris Berg, Inc.* v. *United States*, 426 F.2d 314, 315, 318 (reformation appropriate when the Navy violated regulations by failing to consider evidence of error resulting in an unreasonably low bid price).

Consideration of the outcomes of various contract disputes under the panel decision demonstrates the untenable nature of its holding. The panel held that (1) the price term of the contract was invalid, and (2) although the contract was not void *ab initio* (per the *en banc* decision), no cause of action was available under Section 8118, the statute rendering the price term invalid. Therefore, petitioner had no right to recovery. This holding readily allows the following two hypothetical scenarios to occur:

- Contractor and Navy enter into a fixed-price contract for $25 million, and contractor fully completes the contract but incurs only $5 million – not $25 million or anything close to it – in total costs. The Navy, using Section 8118 as a sword, refuses to pay more than $7 million. Under the lower court's holding, Contractor cannot recover the remainder due, even though it took the risk under the contract. Cf. *United States* v. *American Renaissance Lines, Inc.*, 494 F.2d 1059 (D.C. Cir. 1974) (holding that the government should not be allowed to hide behind its own failure to follow regulations and limit the private party to *quantum meruit* recovery).
- Contractor and Navy enter a fixed-price development contract that violates Section 8118. Contractor discovers that its costs will exceed the contract price, and the Navy refuses to restructure – so Contractor ceases working. When the Navy sues on the contract, the Contractor counter-claims arguing that the Navy drove it into default. Under the *en banc* decision below, the contract is enforceable, but under the panel

decision the Contractor has no claim for the violation of Section 8118 – so the Navy wins on both claims.

In both hypothetical situations, and indeed in every imaginable situation subject to the panel decision, the risk of an illegal term in a contract is borne solely by the contractor. Cf. *Johnson Mgmt. Gp. CFC, Inc.* v. *Martinez*, 308 F.3d 1245, 1259 (Fed. Cir. 2002) (Newman, J., dissenting in part) ("[T]he government bears neither the responsibility for its error nor the obligation to correct it to a mutually acceptable alternative."). By contrast to the results under the court's holding, an appeal to the contract-law doctrines of implied-in-fact contract and contract reformation produces consistent and defensible results. These rules that are available to contracting parties in other sectors of the economy should not be denied to defense contractors simply because they do business with the United States. Cf. *Mobil Oil Expl.*, 530 U.S. at 607 ("'When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.'"); *Johnson Mgmt. Gp.*, 308 F.3d at 1261 ("[T]he laws of contract and the rules of fair dealing do not evaporate when the government is a party. When a contract provision becomes illegal, whether due to later-discovered error or statutory enactment, the party that produced the illegality is liable for the injury caused thereby.").[5] Government contractors cannot maintain long-term operation without the certainty that the rule of law provides.

II. THE PANEL DECISION WARRANTS REVIEW BECAUSE OF ITS FAR-REACHING EFFECT AND THE INDEFENSIBLE BURDEN PLACED ON THE DEFENSE CONTRACTING INDUSTRY

A. *The Navy's Use of Fixed-Price Contracts Violated Congress's Express Directive.* Notwithstanding Section 8118

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[5] See also *John Doe Agency* v. *John Doe Corp.*, 493 U.S. 146, 158 (1989) (statement of Blackmun, J.) ("Simply because a party is a defense contractor does not mean that all doubts automatically are to be resolved against it * * *.").

(quoted at page 2, *supra*), the Navy entered into a large number of fixed-price contracts for systems development – contracts that are subject to Section 8118, or the section's equivalent in subsequent appropriations acts – *without* seeking or receiving prior written approval from the Under Secretary of Defense, *without any* determination that program risk had been reduced or that reasonable pricing could occur, and *without* regard for the fact that program risk in the illegal fixed-price-type contracts fell solely on the shoulders of the contractors. See Pet. App. 112a. No dispute exists that Section 8118 has been honored primarily in the breach. See Pet. App. 4a.

The Navy's failure was part of a long-running practice of turning a blind eye to the well-understood risks of fixed-price development contracting, and ignoring Department of Defense directives (DODD) and the relevant Federal Acquisitions Regulation (FAR). See FAR, 36 C.F.R. § 35.006(c); DODD 5000.1, ¶ D.9.g. Indeed, the FAR and DODD came about largely in response to the spectacular failure of fixed-price, "Total Package Procurement" contracts – including such well-known programs as the development and production of the F-14 aircraft, which resulted in substantial cost overruns and required "extraordinary relief" under the then-applicable Public Law No. 85-804, 72 Stat. 972 (1958). See generally Norman R. Augustine & Robert F. Trimble, *Procurement Competition at Work: The Manufacturer's Experience*, 6 YALE J. ON REG. 333, 345-347 (1989). Even so, in the mid-1980s the Navy renounced the FAR and DODD and returned to fixed-price development contracting, to which practices Congress directed its attention when enacting Section 8118: "The Committee is concerned about the Navy's policy regarding fixed-price contracting * * *." H.R. Rep. No. 100-410, 100th Cong., 1st Sess., at 203 (1987). The Conference Report accompanying Section 8118 stated: "The conferees also agree * * * with language encouraging the Navy to review its policy in particular." H.R. Conf. Rep. No. 100-498, 100th Cong., 1st Sess., at 623 (1987).

Congress's approach under Section 8118 was to impose after-the-fact, quarterly reporting requirements about the

Defense Department's compliance with the limitations on fixed-price development contracts, in order to avoid "the appearance of Congressional micromanagement." H.R. Conf. Rep. No. 100-498, at 623. Where Congress, when exercising its appropriations powers, relinquishes any active oversight role, it is incumbent on the judicial branch to ensure that constitutional separation of powers is not upset. See generally Kate Stith, *Congress' Power of the Purse*, 97 YALE L.J. 1343, 1386-1387 (1988) ("[T]he courts may be available to determine authoritatively whether the operating branch of government has complied with the specified limitations.") (citing *TVA* v. *Hill*, 437 U.S. 153 (1978)). In its decision below, the Federal Circuit panel abdicates its role.

B. *Other Cases Implicating Section 8118 and Other Statutes Are Placed in Uncertainty By the Panel Decision.* Certiorari is also appropriate because of the impact on the defense contracting industry, and the possible effect on the future ability of the Department of Defense to find private companies willing to undertake inherently speculative defense contracts.

Other contracts collectively worth hundreds of millions of dollars, including contracts involving members of *amici* organizations, also suffer the same malady under Section 8118. Some of those contracts are the subjects of litigation, involving issues identical to that raised in the petition, currently in the Court of Federal Claims – and are bound by the panel decision below. See Pet. 14 (citing three active suits by defense contractors against the United States raising the same issue as this case); cf., *e.g.*, *Northrop Grumman Corp.*, 47 Fed. Cl. at 26 (noting that "Congress precluded this type of contract during three years of its performance," and relying on the *en banc* decision below to hold that the available remedies are implied-in-fact contract, reformation, and enforcing the contract as it is written). The case currently before the Court is the first Section 8118 case to reach final resolution in the Federal Circuit. Hundreds of millions of dollars are at stake between these various cases. Review by this Court will place at rest an issue that promises to confound the lower courts and waste years and millions of dollars in litigation. See Pet. 14-15.

Beyond the cases implicating Section 8118 and its successors, cases regularly come to the Court of Federal Claims and the Federal Circuit raising analogous issues of illegality, demonstrating that the problem of illegal terms in government contracts is a recurring issue. In *Johnson Mgmt. Gp.*, 308 F.3d at 1253-1256, a contractual advance payments clause in a service contract violated both the applicable statute and the interpreting regulation, so the clause could not be enforced. Over a dissent by Judge Newman (*id.* at 1259-1262), who objected to placing the entire risk of the illegality on the contractor, the contract was enforced without the illegal clause, and without any remedy aimed at capturing the intent of the illegal clause, because "the * * * contract, as a whole, remained valid and enforceable." *Id.* at 1257 & n.4 (citing *Urban Data Sys.*, 699 F.2d at 1154). Both *La Gloria Oil & Gas Co.* v. *United States*, 56 Fed. Cl. 211, 224 (2003), and *Gold Line Refining, Ltd.* v. *United States*, 54 Fed. Cl. 285, 298 (2002), raise the issue from *Barrett Refining* –the measure of recovery available to an aggrieved contractor that supplied fuel to the U.S. military under a contract with an illegal price-adjustment clause. The final holding in the tortured litigation below submits all such cases that are active or yet to arise to uncertainty. See, *e.g.*, *Gould II*, 67 F.3d at 930; cf. Pet. 15 (discussing the Navy's recent arguments in *Gould* that the litigation before this Court established "the principle that funding statutes * * * are not judicially enforceable by contractors").

The defense contracting industry as a whole stands to suffer if the holding below stands. Contractors, including many members of *amici* organizations, that have rights to contract-law remedies in the face of illegal contract terms but are prevented from exercising those rights will suffer real and immediate economic loss. Section 8118 and subsequent versions of the statute were enacted to prevent just the concern that arises in this case – that of "the contractor * * * sustaining losses through unanticipated costs" on "development programs involving such a high degree of innovation that realistic pricing is not possible." S. Rep. No. 100-326, 100th Cong., 2d Sess.,

at 104 (1988). After violating the statute in this case and others, the Navy has been unsympathetic to requests to restructure the contracts (see Pet. App. 35a), and has attempted to impose on contractors the entire burden of the cost overruns. The decision below allows the Navy to do just that. In an industry where even contracts that do not result in protracted litigation over cost overruns and illegal contract terms can provide "perilously low levels of return for defense contractors," Augustine & Trimble, *supra*, at 344, the Navy's conduct in these cases is another risk that contractors can ill afford to bear.

Also, the Navy's reliability as a contracting partner is at stake in this litigation. During the time period when the contract giving rise to this litigation was entered, the Navy unabashedly entered into contracts with price terms violating statute (Section 8118 and its successors), FAR, 36 C.F.R. § 35.006(c), and DODD 5000.1, ¶ D.9.g. The Navy is able to require the contractor to perform its obligations fully, as the penalties for default on a government contract are extraordinary. Finally, when one or more of the contract terms are illegal, under the Federal Circuit rule the Navy escapes responsibility for its obligations to comply with the law. Contractors' willingness and ability to enter into and perform inherently speculative development contracts are, and will continue to be, compromised. See Augustine & Trimble, *supra*, at 340 (emphasizing the value of "[s]upplier loyalties stemming from good relationships" and adding, at roughly the time the contract in this case was entered into, that "relationships between the federal government and its prime contractor suppliers are more strained today than ever before"). Congress sought to avoid this very result, and the conference report noted the need to "maintain the government's credibility as a reliable business partner," and the challenges to doing so in the face of inappropriate use of fixed-price development contracts. H.R. Conf. Rep. No. 100-498, at 623.

C. *The Panel's Waiver Discussion Improperly Places the Burden of Compliance on the Contractor.* The court below suggested that petitioner had waived its claim by voluntarily

entering into a fixed-price development contract. Pet. App. 11a-14a. The waiver discussion is another red herring masking the salient issues that arise from the Navy's violation of Section 8118 – how to define a term that is rendered non-existent by operation of law.

The suggestion of waiver is also at odds with this Court's well-established rule. Circumstances certainly exist where a contractor's failure to raise an issue before entering into the contract should constitute a waiver of that issue. See, *e.g.*, *United Int'l Investigative Servs.* v. *United States*, 109 F.3d 734, 738 (Fed. Cir. 1997) (ambiguity in the specifications for the contract was patent and should have been raised before bidding on the contract). But this Court has consistently held that waiver "will not be permitted to thwart the purposes of statutes of the United States." *Sola Elec. Co.* v. *Jefferson Elec. Co.*, 317 U.S. 173, 176 (1942). A waiver rule regarding violations of Section 8118 directly contradicts this Court's authority, and could have the effect of writing the doctrine of contract illegality out of the law. If by entering into a contract with an illegal term, the parties waive the right to contest that term, no party with standing to sue could possibly contest the contract. Indeed, the panel's waiver discussion may yield another perverse result. This litigation is ample evidence that, without a suit on the contract by an aggrieved contractor, the Navy's violation of Section 8118 would go unchecked. To read Section 8118 as not *affirmatively providing* a cause of action is one thing; it is something else entirely to read it as *precluding* a cause of action grounded in principles of contract law or (under the waiver discussion) as placing the burden on the contractor to police the Navy's compliance with federal statutory law at the time of contracting. See Richard E. Speidel, *Contract Excuse Doctrine and Retrospective Legislation: The Winstar Case*, 2001 WIS. L. REV. 795, 818 & n.122 ("In most government contracts, the markets are limited to competition among private contractors seeking government business, and the government has superior bargaining power with which to call the shots.").

A new waiver rule applicable to violations of Section 8118, its successors, or other federal statutes will have very real and immediate consequences for defense contractors. Members of *amici* are alarmed that the panel below's waiver discussion might be read as Federal Circuit law.[6] Those contractors who remain in litigation against the United States over contracts subject to Section 8118 (and subsequent iterations of the statute), as well as contractors with provisions that are invalid by operation of other federal statutes, face having their claims thrown out because of improper invocation of a waiver rule. Contracts not yet bid will also be subject to the rule. The adhesion-contract negotiation process between the Department of Defense and contractors in effect, if not in fact, precludes a contractor from contesting specific terms of a contract during the bidding process. See Speidel, *supra*, at 818; Pet. 4. The speculative nature of development contracts, like the contract underlying this litigation, also prevents a contractor from reasonably assessing the cost and the risk involved in performing the contract. If entering into a contract without objecting to its terms constitutes a waiver, contractors may be relegated to the Hobson's choice of choosing not to bid or entering a contract relationship without legal protection.

CONCLUSION

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted.

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[6] In *Beta Systems*, the court specifically considered a waiver argument by the government and reached the opposite result from this case, holding: "[I]t is not controlling whether or not Beta or the government foresaw, or accepted the risk of failing to foresee, this defect in the index." 838 F.2d at 1186. Thus on this issue, as on the primary issue in the case, inconsistent Federal Circuit case law leaves parties in an unacceptable position.

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IN THE

Supreme Court of the United States

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
and
LUCENT TECHNOLOGIES INC.,
Petitioners,

v.

THE UNITED STATES,
Respondent.

On Petition For A Writ of Certiorari To The United States Court of Appeals for the Federal Circuit

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Pursuant to Sup. Ct. R. 15.8, petitioners AT&T and Lucent wish to call the Court's attention to *Hermes Consolidated, Inc. d/b/a Wyoming Refining Co. v. United States*, No. 02-1460 C, 2003 U.S. Cl. LEXIS 237 (Fed. Cl. Aug. 7, 2003) (denying cross-motions for summary judgment) and *Calcasieu Refining Co. v. United States*, No. 02-1219C, 2003 WL 22049528 (Fed. Cl. July 31, 2003) (unpublished) (denying cross-motions for partial summary judgment). These recent Court of Federal Claims decisions struggle with the confusion created by the Federal Circuit's *AT&T V* opinion below, and thus underscore the need for this Court's review. For example, on the important, recurring issue of whether a government contractor can "waive" an illegal contract or contract term, the *Hermes* opinion emphasizes that as a result of *AT&T V*, there now "appears to be conflicting precedent from the Federal Circuit." 2003 U.S. Cl. LEXIS 237, at *34; *see also id.*, at *3 ("the precedent of the Federal Circuit appears to be of two minds"); at *64 ("the Federal Circuit's law on waiver is not clear"). Only this Court can restore clarity within the Federal Circuit.

1. *Hermes* and *Calcasieu* are two of the pending military jet fuel cases, in which numerous oil companies have filed more than $2 billion in claims against the United States for including an illegal pricing provision in their supply contracts. They are additional cases, unrelated to § 8118 of the Defense Appropriations Act, in which the Government has attempted to deploy *AT&T V* as a new, lethal weapon for summarily terminating any major compensation claim alleging that a federal government contract or contract term is illegal. *See* Petitioners' Reply Br. at 7-8. Indeed, at the same time the Government argues in this Court that *AT&T V* has little relevance to other cases, "[t]he government . . . *argues strenuously* [in *Hermes*] that Judge Plager's dissent [in *AT&T III*] and the *AT&T V* opinion *control* [the *Hermes*] *case*." *Hermes*, 2003 U.S. Cl. LEXIS 237, at *55 (emphasis added).

2. In discussing the background of the *AT&T* litigation, both *Calcasieu* and *Hermes* highlight the way in which the majority opinion in *AT&T V* completely contradicts the Federal Circuit's *en banc* opinion in *AT&T III*. Quoting "an important, if general, statement in the Federal Circuit's *en banc AT&T* III decision," *Calcasieu* indicates "the Federal Circuit recognizes that a contractor may have lost the right to have its contract declared void *ab initio* . . . but may not forfeit a remedy." 2003 WL 22049528, at *10; *see* Pet. App. 48a. Yet, as *Calcasieu* explains, *AT&T V* affirmed the trial court's (inexplicable) holding, on remand from *AT&T III*, "that the statute conferred no protectable interest in its proper application, or no private right of action, so that [AT&T] was not entitled to a remedy." 2003 WL 22049528, at *10. *See also Hermes*, 2003 U.S. Cl. LEXIS 237, at *49 ("the court [in *AT&T III*] held that AT&T, having fully performed on the illegal contract, could nevertheless recover under a theory of implied contract or reformation"), *but also* at *53 ("the crux of the Federal Circuit's holding [in *AT&T V*] was to deny AT&T a remedy").

3. *Calcasieu* explains that in *AT&T V*, "the court's statements about waiver were dicta." 2003 WL 22049528, at *11; *accord Hermes*, 2003 U.S. Cl. LEXIS 237, at *56 (the *AT&T V* waiver discussion "is *dicta* because it is unnecessary for the disposition of the case, which was predicated upon a failure to state a claim"); *see also id.* at *57-*58 (discussing, but not resolving, the question of whether under the "Law of the Circuit" doctrine, the majority opinion of the three-judge panel in *AT&T V* can supersede the majority opinion of the *en banc* panel in *AT&T III*). The Government, however, has continued to flaunt the *AT&T V* majority opinion's gratuitous commentary on waiver as if that *dicta* were binding precedent which compels dismissal of any claim against the United States involving an illegal contract or contract term, where the contractor did not formally object prior to award. For example, in addition to invoking *AT&T V*'s waiver "holding"

in *Hermes*, *Calcasieu* and other pending jet fuel cases, the Government has continued to raise it before the Court of Federal Claims in *Gould, Inc. v. United States*, No. 95-88C, which involves a different military procurement (*see* Pet. Reply Br. at 7-8). More specifically, in a *Gould* reply brief filed subsequent to *Calcasieu*, the Government argues that the *AT&T V* majority *dicta* somehow "make it plain" that certain Federal Circuit precedents "are questionable upon the issue of waiver." Def. Reply Br. at 28 (Aug. 4, 2003).

4. The *Calcasieu* opinion reflects the Court of Federal Claims' uncertainty regarding how to reconcile the waiver *dicta* in *AT&T V* with the Federal Circuit's prior precedent on waiver. For example, the *Calcasieu* opinion observes "that *AT&T* V does not draw a bright line between an infirmity in the nature of the type of contract authorized and one in a pricing provision that translates to a rule on waiver." 2003 WL 22049528, at *11.

5. *Calcasieu* explains that "[t]he dissent in *AT&T* V was aghast that the trial court was not directed to take evidence on this issue before the panel majority opined on waiver." *Id.*, at *11 (citing 307 F.3d at 1382-83 (Newman, J., dissenting)). As a result, the *Calcasieu* opinion "draws . . . the cautionary lesson" that there must be "an appropriate factual record" before "waiver may apply." *Id.* Thus, rather than granting the Government's summary judgment motion on the ground of waiver, the Court of Federal claims indicated in *Calcasieu* that its "decision on waiver will benefit from further development of the record." *Id.* at 14. Similarly, in *Hermes*, the court requested supplemental briefing on the question of whether "a hearing or trial [is] necessary in order to develop a factual record on the issue of waiver." *Hermes*, 2003 U.S. Cl. LEXIS 237, at *66. In stark contrast, and as Judge Newman's dissenting opinion in *AT&T V* emphasizes, the *AT&T V* majority opinion's waiver discussion is based on "hypothesis" and "speculative

theories," not on "evidence or findings" or facts "in the record." Pet. App. 16a-17a. This is necessarily the case because the Federal Circuit and Court of Federal Claims have deprived the petitioners of their day in court.

For the foregoing reasons, and those previously presented, the petition for a writ of certiorari should be granted.

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